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Mr Henrik Bjerre Nielsen
Chairman
CEIOPS

Dear Mr Nielsen

Comments on CEIOPS Consultation Paper No. 4
Draft Answers to First Wave of Calls for Advice (Solvency II)

I have pleasure in attaching the comments of the Groupe Consultatif on CEIOPS' draft answers to the European Commission's first wave of calls for advice.

In general, the Groupe supports the majority of CEIOPS' responses and the comments below relate only to those responses the wording of which we consider needs to be amended. Before dealing in detail with each of the draft answers, we would offer some general comments on the document submitted by CEIOPS. Our comments follow the same order as the CEIOPS consultation paper.

1. CEIOPS draft answers to the first wave of calls for advice (CFAs) by the Commission are an important contribution to the determination of the second pillar of the Solvency II construction. However it appears that not all of CEIOPS draft answers are at the same level: some include detailed implementing measures whereas others set out high level principles.

The Groupe Consultatif appreciates that Solvency II is a work in progress and that some Pillar II measures cannot be designed until Pillar I prescriptions are fixed, but it is not yet clear which future implementation measures will be decided at EU level and which will be left to national regulators. Therefore the comments on high level principles cannot foreshadow the comments on implementation measures, and we hope that CEIOPS takes an active role in the determination of implementation measures in order to progress towards harmonisation.

2. We note that several draft answers result in the proposal that the supervisory authority is not bound by strict rules and can take action on its own judgement (see s.106 and 107, s.126, s.136 and 138). We appreciate that the valuation of a company's solvency cannot rely only on rules and formulas and that it is necessary that the supervisory authority's action cannot be triggered by the breach of rules or of limits, but we regret that the CEIOPS draft answers do not mention which procedure would be applied to ensure that action taken is fair and reasonable.
3. We are somewhat uncertain about what difference is intended, in this document, between the terms *strategy* and *policy*.

CFA n° 1: Internal Control and Risk Management

Governance

4. We support the suggestion that the Framework Directive should include high level principles on Governance, but we note that CEIOPS mentions neither risks nor actuaries.
5. We believe that CEIOPS' advice (section 36) should include the principles of risk management among the matters to be addressed by the system of governance of an insurance undertaking. We would suggest including in section 36 a wording similar to the wording included in paragraph 1 of CRD's article 22, with the addition of assessment of risks as a crucial stage of any risk management system. Hence the suggestion to word as follows the second sentence of the second paragraph of s.36:

"This implies an appropriate organisational structure, set of responsibilities and "fit and proper" requirements, effective processes to identify, assess, manage, monitor and report the risks it is or might be exposed to, as well as an appropriate and understood system of internal control, suitable reporting arrangements, and an audit framework."
6. We believe that the system of governance of an insurance undertaking should deal with the relationship between the Board of Directors, the Senior Management and those experts who are competent in advising the Board on the assessment of the risks and of the impact of mitigation measures. We acknowledge that this answer might not be the suitable place for dealing with the role of actuaries, and would suggest adding the following sentence at the end of s.35:

"The potential role and responsibilities of actuaries within the overall system of governance may be considered in CEIOPS' answers to subsequent Calls for Advice."

In case it is considered inappropriate to refer to actuaries in this section, we would then suggest deleting the second sentence of s. 58 because it would not be correct to give the impression that actuaries may have a role in internal control and none in the system of governance.

Risk Management

7. We are surprised that there is no reference to actuaries within this chapter, whereas there is a reference in the internal control chapter in s. 58. Risk Management involves actuaries, at least in the measurement of those risks which can be quantified. Therefore we would suggest adding the following sentence at the end of s.39:

"The potential role and responsibilities of actuaries within the overall process of risk management may be considered in CEIOPS' answers to subsequent Calls or Advice."

In case it is considered inappropriate to refer to actuaries in this section, we would then suggest deleting the second sentence of s. 58 because it would not be correct to give the impression that actuaries may have a role in internal control and none in the Risk Management process.

8. We wonder why CEIOPS does not stress that risk management is a process involving all levels of personnel as it does for internal control. In the Insurance industry, a Risk Management process would not be efficient if all members of staff were not risk conscious; for instance, the most relevant underwriting guidelines will prove inefficient if underwriters are keener to have risks facially fitting in the guidelines than to identify risks hidden in the business.

Sentences such as: “The Board of Directors is responsible... for establishing a culture within the undertaking that emphasises and demonstrates to all levels of personnel the importance of internal control” (s.62) or “Senior Management should ensure that all personnel understand their role in the internal control process and are appropriately engaged in the process” would usefully be transposed into the Risk Management chapter.

9. It is not clear what is meant by “plan, direct ... the impact ... of risks” in the wording of s.49. Furthermore, this wording does not reflect the role of the Risk Management function in the identification, the assessment and the mitigation of risks. We would suggest the following wording of s. 49:

“The role of the risk management function is (a) to ensure and/or undertake that all risks the undertaking faces or may face are identified and adequately assessed, (b) to advise the Board of Directors on the actions to be taken in order to keep the risks within limits at least consistent with the solvency position, and (c) to report to the Board of Directors on the development of risks.”

In the above wording, it is left to each undertaking to determine whether the identification and/or the assessment of risks are performed by the risk management function or are performed by operational functions and checked by the risk management function. For solvency purposes, it is important not to limit the scope to risks faced by the undertaking and to extend it to risks it may face.

10. We suggest the following wording of the beginning of s.52: “Insurance undertakings are required to have in place processes that allow quantitative *and/or* qualitative measurement”. The reason is that there are risks whose quantification is not possible.

Internal Control

11. We acknowledge that Internal Control should contribute to the effectiveness and the efficiency of operations and to adequate control of risks, and is part of a prudent approach of business; but we consider that the definition proposed in s. 61 might be confusing in the sense that the continuous processes of Internal Control are not the main factor ensuring efficiency of operations, adequate control of risks or prudent approach to business. Moreover it could give rise to the interpretation that these major responsibilities rest with the Internal Control function and not with the Board of Directors.

We suggest the following wording of s.61:

“Internal Control is a system of continuing processes carried out by the undertaking’s Board of Directors, Senior Management and all personnel, designed to ensure that internal policies and procedures are effectively implemented and applied, that financial and non financial information is reliable, and that regulation are complied with.”

12. The second sentence of s.69 should be deleted because ICT risks are operational risks within the ambit of Risk Management, and it is preferable not to mention one specific aspect of one specific operational risk.

CFAs n° 5 & 6: Investment Management Rules & ALM Rules

13. We acknowledge that, at this stage, the intention of CEIOPS was to lay down high level principles and not to enter into specifics of the different classes of business, namely Life and Non Life. However the choice to draft an answer common to Life and Non Life results in an explanatory text that is not quite relevant for each class and that is often more Life orientated than Non Life.
14. It is our opinion that a risk based approach to solvency, provided that it adequately captures all risks related to assets, should eliminate the need for regulatory limits on investments. We recognise that the standard formula cannot capture the exact risk profile of an undertaking and that it is logical to impose regulatory limits on the investment of a company relying on the standard formula, but we consider that approved internal models should capture adequately the undertaking's investment risks and eliminate the need for regulatory limits.

For those companies that will rely on the standard formula, the issue of determining whether the same limits would apply to investments covering provisions, MCR and SCR depends on the definition and level of SCR. We propose that the issue remains pending until SCR is completely defined.

Thus we would suggest the following wording of s.105:

“CEIOPS recommends that some investment and concentration limits are imposed on undertakings which calculate their SCR using the standard formula or a partial model. CEIOPS recommends that the same limits are applied to assets covering technical provisions and MCR, and will provide further advice on the assets covering SCR in the answer to Call for Advice n° 9”.

15. We do not understand the reasons why a further capital requirement should be necessary to address diversification (s. 106), and undertakings would be expected to do more than merely satisfy the limits in Pillar I (s. 107). It is suggested either deleting sections 106 and 107, or providing in the explanatory text the reasons for such special treatment of diversification.
16. We suggest splitting s.109 into two sections as it deals with two related but distinct matters: ALM policy and investment policy.

As for ALM policy, at first glance the critical difference is between classes including or not a guaranteed return rather than between long-term and short-term risks. Anyway it would be helpful to introduce a definition of long-term and short-term risks.

As for investment policy, it is not clear whether the proposal in s.109 implies that the requirement is to design an investment policy addressing all the items listed in s.101. If yes, the third bullet point of s.101 should not refer to the way in which the company exercises its discretion in relation to with-profit business because it is not the right place to decide such a policy which goes beyond the investment policy.

CFA n° 2: Supervisory Practices regarding Solo Companies (General)

17. We recognise that this answer is a first step on the way to harmonisation of supervisory practices, but we regret that the goal of convergence is not mentioned in the answer.
18. It is not clear which high-level principles are endorsed by CEIOPS: the Article suggested by the Commission services or a CRD-like wording as suggested in s.117. It is not possible to comment on s.119 as long as this is not clarified.

CFA n° 3: Supervisory Practices (Quantitative Tools)

19. The purpose of quantitative tools is not set out but for early warning indicators in s.131. As the answer stands, it is not known in which circumstances and for which purpose the use of a quantitative tool would be required, nor which consequences would arise from the results of its application.

It is desirable that the purposes and the consequences of the use of quantitative tools are stated, preferably in the Framework Directive. It is also desirable to state that the results of the application of any quantitative tools will be kept confidential by the supervisory authority.

We would recommend that it is clearly stated that tools such as early warning indicators, stress tests, sensitivity testing, scenario analysis, etc. are tools relevant for measuring capital needs only when they simulate the effects of events whose probability can be estimated.

20. We fully appreciate that the supervisory authority needs a large degree of flexibility in the prescription of the use of quantitative tools as is requested in s.136 and in s.138, but this flexibility should be exercised within limits laid down as suggested in s.20 above.

21. There is no definition of the “long term resilience tests” that would be part of the evaluation process performed by the supervisory authority (s. 137 and 139). It would be useful for a definition to be given in the explanatory text or in Annex I.

22. We support the proposal of a multiple-staged approach for harmonisation as set out in s.138, subject to the above comment under s.21.

CFA n° 4: Transparency of Supervisory Action

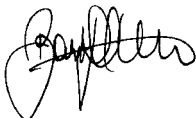
23. In s.156, it is necessary to make it clear that the supervisory authority will not impose remedial action without a prior hearing of the undertaking during which it has the opportunity to develop its own analysis of the situation, of the figures and data, etc. This is important for ensuring that conclusions rely on a correct analysis and that remedial action is appropriate to the actual situation.

Therefore we would suggest adding the following sentence at the end of s.156:

“The Board of Directors will be allowed a delay to comment on the document communicated by the supervisory authority. Remedial action will not be prescribed and/or sanctions will not be taken by the supervisory authority prior to the expiration of this delay”.

I hope the foregoing comments are of assistance to CEIOPS. In conclusion, let me add once again that the Groupe Consultatif welcomes the opportunity to contribute to the Solvency II project through direct dialogue and interaction with CEIOPS and its working groups. As always, we are available for further discussion and input as you consider appropriate.

Yours sincerely



Bart De Smet
Chairman, Insurance Committee