

Comments Template on CEIOPS-CP 46 Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility		Deadline 11.09.2009 4 p.m. CET
Name of Company:	AMICE	
Disclosure of comments:	CEIOPS will make all comments available on its website, except where respondents specifically request that their comments remain confidential. Please indicate if your comments should be treated as confidential:	No
The numbering of the paragraphs refers to Consultation Paper No. 46 (CEIOPS-CP-46/09).		
Reference	Comment	
General Comment	<p>These are AMICE´s views at the current stage of the project. As our work develops, these views may evolve depending on the other elements of the framework which are not yet fixed.</p> <p>AMICE members are convinced that the increase in the amount of specifications appointed by CEIOPS aims to improve the protection of policyholders by enhancing the quality of capital available. However these requirements may have a perverse effect on the availability of certain elements of capital, making it harder to raise new capital and increasing the financing costs (potential capital providers may react negatively to the imposition of certain limits) As a result consumers will be faced with a higher cost of insurance.</p> <p>Secondly, the requirements for subordinated liabilities are very restrictive and not in line with current practices in capital instruments. Capital instruments where redemption is linked to the undertaking's solvency position, and not necessarily to their ability to absorb losses should be allowed either in Tier 1 or 2. Should this possibility not be allowed, this could lead to severe difficulties to obtain external financing.</p> <p>Thirdly, we consider that the limits proposed by CEIOPS (50% for Tier 1, 15% for Tier 3) are not consistent with the Level 1 text. CEIOPS is not providing satisfactory reasoning for a more restrictive tiering.</p> <p>Furthermore, AMICE is not in favour of classifying the difference between the best estimate and the</p>	

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	<p>amount to be paid in case of winding-up (we understand the latter equals the local GAAP technical reserve), as Tier 3. The main reasons are the following:</p> <ul style="list-style-type: none"> - Since this amount is included in the difference between assets and liabilities, the Level 1 text considers this amount as basic own funds. - It could be very demanding and burdensome to model best estimate run-off expenses. Moreover, winding-up technical provisions would probably be lower than on-going technical provisions, if undertakings assume to apply reduced expenses in the majority of departments (commercial, strategic, financial...). - QIS 4 showed that the best estimate of technical provisions (which included part of the unrealized gains) was higher than local GAAP technical reserves in the life insurance business. If this amount is disconnected from unrealized capital gains or losses, this will lead to negative values of Tier 3 own funds. - There is a risk that changes in this amount will be considered in the SCR calculation (e.g. in the mass lapse risk module) without being recognized in the eligible elements of capital (if the 15% threshold is breached); Therefore we wonder whether this statement is consistent with the Level 1 text of the Directive. <p>For the reasons mentioned above, we believe this item should be recognised as Tier 1 eligible elements of capital.</p> <p>AMICE members have also the following remarks:</p> <p>No reference is made to grandfathering. We are of the view that special attention should be paid to capital instruments that have been issued before Solvency II enters into force.</p> <p>We would also like to note that no explanation is given to exclude liabilities shorter than 3 years (eligible amount should cover any event within one-year horizon) from the eligible elements of capital.</p> <p>We have concerns about CEIOPS proposal on “net financing”. Investment in capital instruments (as equities or bonds) should not be covered by the net financing approach and should only be limited to loans. This would be an adverse change compared to the current situation.</p>	

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3.26.	<p>CEIOPS is of the view that the term <i>substantially</i> in article 94(1) must be construed narrowly for the implementing measures in particular with regards to hybrid instruments which have not stopped paying coupons from the beginning of the financial crisis unlike shares.</p> <p>CEIOPS interpretation deviates from the Level 1 text. <i>Substantially possess</i> has a rather significant meaning than <i>fully possess</i>.</p> <p>See also paragraph 3.85.</p>	

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3.29.	<p>CEIOPS argues that no deferral of interest on hybrid capital instruments occurred during the crisis whereas at the same time dividends on ordinary shares were reduced or withheld.</p> <p>CEIOPS compares hybrids with shares which did not distribute dividends during the crisis. It should be noted that there is no contractual obligation to pay dividends, but there is a contractual obligation to pay interests on hybrids. These agreements must be respected.</p>	
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3.31.	<p>CEIOPS writes “Hence, in addition to requiring Tier 1 to be the highest quality own funds, CEIOPS is of the view that the proportion of Tier 1 items in eligible own funds must be <u>significantly higher than one third</u> of the total amount of eligible own funds.”</p> <p>The Level 1 text writes ‘at least... higher than 1/3’. AMICE members argue that CEIOPS interpretation of ‘significantly higher’ is not in line with the Level 1 text.</p>	
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3.38.	The limits proposed by CEIOPS (50% for Tier 1, 15% for Tier 3) are not consistent with the principles of the Level 1 text. Additionally, CEIOPS is not providing satisfactory reasoning for a more restrictive tiering.	
3.39.	CEIOPS writes that own funds that have been called up but not paid in will also be subject to a capital charge for counterparty risk, as in the case for other receivables which have not been paid in. The	

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	<p>purpose of this requirement is to address the potential default risk and is still considered necessary even if the called-up capital is included in Tier 2. This is because counterparty default would also prevent capital absorbing losses in a winding-up.</p> <p>AMICE understands that the capital charge for counterparty default risk in case of supplementary calls should also take into account the contractual nature of the member/mutual relation.</p>	
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3.69.	We do not share CEIOPS views on the need to develop Level 2 measures directly linking the duration of capital instruments with the duration of liabilities.	
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3.85.	See our comments to paragraph 3.26.	
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3.102.	AMICE suggests waiting for IASB developments on the topic. AMICE members believe that <u>profit at inception</u> should be taken into account as a part of eligible own funds and should be classified as <u>Tier 1</u> to the extent that it belongs to surplus assets over liabilities.	
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3.134.	<p>AMICE members reject the idea that supplementary calls can only be called when sustaining losses (when in fact they can be called for other reasons). This has a bearing on obligations to disclose calls. This would thus render the effort to raise funds very difficult. We therefore suggest the following rewording suggestion:</p> <p>Supplementary member calls are claims that a mutual or mutual-type undertaking with variable contributions has on its members to provide consideration when it sustain losses to provide cash to</p>	

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	replenish own funds	
3.135.	AMICE members agree with the wording of this paragraph – we understand “on demand” as “immediately and unconditionally”, eg. as not depending of a preceding resolution of the general meeting etc.	
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3.138.	<p>The split 40:60 is a compromise and AMICE members argue that all (= 100%) of the supplementary calls’ facility within the next twelve months should be classified as Tier 2, if the criteria for inclusion of ancillary own funds in Tier 2 are fulfilled.</p> <p>Supplementary calls within the next 12 months which do not fulfill the criteria to be considered as Tier 2 together with supplementary calls beyond 12 months should be classified as Tier 3, if the criteria for inclusion of ancillary own funds in Tier 3 are fulfilled.</p> <p>We note that 2007 CEIOPS survey on eligible elements of capital confirmed earlier AISAM-ACME positions on this topic in particular that ‘unbudgeted’ supplementary calls are an essential and fundamental if not exceptional concept for mutual insurers. AISAM-ACME letter also indicated that the amounts received reflect a limited credit risk (1%) and suggested the need for a high acceptance ratio (98-99%) of the potential to call as tier 1 eligible elements of capital. This is also in line with the probability of default which suggests a default of 1% of gross premium debited, which could be potentially higher (and 2% would imply a doubling) (excerpts from letter AISAM-ACME to CEIOPS 24/10/2007).</p>	
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3.164.	AMICE members welcome the introduction of this paragraph in CEIOPS paper.	
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3.170.	Trigger points should be set at the level of the MCR. This will not have an adverse effect on the level of policyholder protection as supervisors can take other adequate measures once the SCR is breached.	
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3.174.	AMICE believes that Level 2 implementing measures should not depart from the criteria used in the QIS 4 Technical Specifications. In this regard, the proportion of Tier 1 items should be at least 1/3 (and not 50%) of the total amount of eligible own funds. There is no justification to either set a minimum limit of 5% or a maximum limit of 15% for Tier 3 eligible elements of capital (Level 1 text defines a maximum limit of 33%).	
3.175.	The limit of Tier 1 capital covering the MCR should be at least 50% of the total amount of eligible own funds (and not 80%). We suggest amending the paragraph as follows: "The proportion of Tier 1 items in eligible own funds is at least 80% 50% of the total amount of eligible own funds".	
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3.180.	<p>CEIOPS mentions that prior supervisory approval is needed whenever any “conversion, redemption or exchange of capital instruments (including premiums paid)” is made.</p> <p>AMICE members believe that the approval process should be facilitated and harmonized through the use of clearly pre-defined criteria. As such, any change in nature of capital instruments or redemption being contractual and the contract being reviewed by the supervisor should not require an additional approval, except in case of breaching the SCR.</p> <p>AMICE underlines that the last supervisory approval must be renewed automatically in order to avoid sticking points for setting up annual reports.</p>	
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3.187.	<p>There is no justification for linking the duration of subordinated debt with the longest liability. Instead, the duration of liabilities should be taken into account as part of the Pillar II supervisory review. These types of instruments are carried out in an on-going manner, and should not be linked to the longest liability.</p> <p><u>We suggest the following wording:</u></p> <p><u>„So, for Tier 1 the minimum maturity will be either the longest dated insurance liability (tentative) or 10 years, whichever is longer; for Tier 2 it will either be the average weighted maturity of all insurance</u></p>	

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	liabilities (tentative) or 5 years whichever is longer and for Tier 3 it will be 3 years"	
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3.191.	<p>CEIOPS writes in Section XVII that at all times coupons/dividends must be able to be cancelled and must at a minimum be cancelled on a breach of the SCR, after which they can only be paid in exceptional circumstances and subject to the consent of the supervisory authority.</p> <ul style="list-style-type: none"> - AMICE members wonder whether coupon payment require supervisory approval when the entity restores its solvency position; - AMICE members have strong concerns regarding CEIOPS proposal on "net financing": Investment in equities or bonds should not be covered by the net financing approach and should be limited to loan agreements; - More clarification is needed about the reason for limiting coupons/dividends with fixed rate. We agree that items with unchangeable coupons should not be classified as Tier 1. However, we disagree with CEIOPS proposal to <u>exclude fixed rate subordinated debt</u> from Tier 1. We do not see any reason not to accept fixed rated debt instruments. We suggest therefore the alternative wording for this paragraph: - "Undertakings should have full discretion over the amount of payment coupons/dividends must not be at a fixed rate and there there should be no preference as to income or return of capital." 	
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3.193.		
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3.195.	<p>We believe in particular that the equalisation provision</p> <ul style="list-style-type: none"> • should be taken into account as a <u>part of eligible own funds</u> and • should be classified as <u>Tier 1</u> in the own funds, to the extent that it belongs to surplus assets over liabilities. <p>In our view, this is also justified because given the strict regulations for its use, the equalisation provision is a capital element in particular for the protection of the rights and benefits of the policyholders.</p> <p>There is no justification for the difference between the value of technical provisions (art 74 to 85) on a going concern basis and the technical provisions in a winding-up with no transfer of portfolios, to be classified as Tier 3. <u>We suggest deleting this paragraph.</u> AMICE supports the idea that all reserves must be included in Tier 1, if not matched with a commitment to be paid to a third party and this without consideration of their legal destination assignment.</p> <p>In addition, it seems irrational to treat certain reserves with less flexibility in a business continuity situation than in the case of a winding up, where all assets will be mobilized.</p> <p>We agree that there should not be any double counting on deferred taxes between own funds and SCR calculation. However, we consider that deferred taxes should be fully recognised, as long as it is probable that they will be recoverable.</p> <p>AMICE considers that the deferred tax position has to be calculated taking into account both the asset and SCR bases. In case of net active position, the share potentially recoverable by the tax authorities (carry back process), must fully included in Tier 1. The excess could be included in Tier 3 in accordance with the reasonable expectation of future profits. For the intangible assets, AMICE considers that if an intangible asset is not set to zero in accordance with CEIOPS requirements, it cannot be excluded from the own funds.</p>	
3.196.	We agree with this paragraph.	

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3.200.	See our comments to paragraph 3.195.	
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3.220.	<p>In our opinion, transparency of supervisory actions should help ensuring harmonization across different Member States.</p> <p>We consider that the reasoning for accepting or rejecting the inclusion of the item into one category should be explicitly stated in the communication between the supervisor and the undertaking. Any other views expressed by other supervisors concerned, or by CEIOPS, within the consultation or mediation process, should also be included.</p> <p>A reasonable timeline should be set for the supervisor to decide whether capital instruments (or any other eligible items) are properly classified or not.</p> <p>Lastly, the undertaking should have the possibility to appeal for a delegation of tasks within the college of supervisors.</p>	
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3.226.	AMICE members welcome the introduction of this paragraph in CEIOPS paper.	
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