



Solvency II implementation measures  
CEIOPS advice  
Second set – June 2009

**AMICE core messages**



[www.amice-eu.org](http://www.amice-eu.org)

Association of Mutual Insurers and Insurance Cooperatives in Europe aisbl

Rue du Trône 98/14 | B-1050 Brussels | Belgium | T: +32 2 503 38 78 | F: +32 2 503 30 55 | [secretariat@amice-eu.org](mailto:secretariat@amice-eu.org)



## AMICE's high-level messages with regard to the second wave of consultations by CEIOPS on their advice for Solvency II implementing measures (CP 39-60)

Summary of responses sent on 11 September 2009

### **CP 39 – TP Best estimate**

Generally speaking, assumptions about the volatility of a market price are better based on an implied volatility wherever markets can be regarded as reliable. Where this is not the case, historic volatilities (which may have to be adjusted for major changes in market conditions) are preferable as they are more stable.

For the assessment of future expenses, the “going concern” approach should prevail until an undertaking has made the firm decision to enter into a run-off state.

### **CP 40 – Risk-free interest rate**

The swap rate curve should be used rather than the ECB government bond yield curve, mainly for the following reasons:

- The swap rate is permanently available from the markets.
- It is in fact used on a day-to-day basis on the markets.
- Implied volatilities can be obtained from the swap curve.

A liquidity premium should be allowed when discounting liabilities which are illiquid by nature (because they are not traded on a deep market). Market participants require compensation for liquidity risk on the assets backing the liabilities and most investors will require a premium to accept an asset (to back the liabilities) which may be hard to trade and hard to value prior to the expected maturity of the instrument.

### **CP 42 – Risk Margin**

The Directive states that the cost-of-capital rate should be the same for all (re)insurance undertakings. This rate should be 6 % without taking into account any supplementary burden.

The concept of unavoidable market risk should be limited to liabilities in currencies where the market is not deep (this risk should be valued at nil for liabilities assessed in euro). Moreover, the unavoidable market risk should only be applicable for long term cash flows if the entity, to which the liabilities are transferred, matches its cash flows and does not invest in equities.

As pointed out in the QIS4 report, the majority, if not all undertakings (independently of their size) use simplifications to project the SCR in the risk margin computation. The non-life risk margin spreadsheet was extensively used by undertakings. Such simplifications should be therefore considered as the standard method.

#### **CP 44 – Counterparty default adjustment**

Calibrating the LGD using a different default probability for each year, or a default probability linked to the amount to recover, is very demanding. This burden is excessive and inadequate for standard formula calculations; the one-year probability of default should be applied to the total amount of recoverable.

Reinsurance agreements with reinsurers that are subject to EEA Solvency II requirements or equivalent regimes should clearly be treated differently from agreements with reinsurers in other jurisdictions. A differentiation in recovery rates is justified.

#### **CP 45 – Simplifications**

Simplifications are at the core of the proportionality principle – a principle that AMICE continuously emphasises on behalf of its many small and medium-sized members. It must be acknowledged that, in addition to the central dimensions of proportionality (“nature, scale, and complexity of risks”), the framework directive explicitly calls for not overburdening small and medium-sized insurers, thus introducing an element of size.

The application of the principle of proportionality should follow the principle-based feature of the Solvency II framework. This means that proportionality should not be applied using a prescribed approach and should not constitute a hard rule.

The potential use of thresholds, either absolute or relative, and the methodology for their calculation should be defined in Level 2.

#### **CP 46 – Own funds**

##### Supplementary calls –

The 40:60 split is a compromise. All (i.e. 100%) of the supplementary call facility within the following twelve months should be classified as Tier 2 if the criteria for inclusion of ancillary own funds in Tier 2 are fulfilled.

Supplementary calls within the following 12 months which do not fulfil the criteria for consideration 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.

### Equalisation reserves

Given the restricted opportunities for mutual and cooperative insurers to raise capital, the treatment of equalisation reserves is one of the most important issues for AMICE and its members. Equalisation provisions should be taken into account as a part of eligible own funds and should be classified as Tier 1 to the extent that they belong to surplus assets over liabilities. A major justification for this request lies in the fact that – due to strict regulations for its use – equalisation provisions are a capital element especially for the protection of the rights / the benefits of the policyholders.

### **CP 47 – Market risk**

#### Interest rate risk:

The interest-rate scenarios will now, unlike in QIS4, capture movements in the level, slope and curvature of the term structure of interest rates and will also allow for an increase in the volatility of interest rates (the interest rate volatility shock will be included in interest level movement shocks [up and down]). Volatility shocks were already included in QIS4. Their inclusion should not result in a more conservative calibration.

#### Concentration risk:

CEIOPS gives no justification for lowering the thresholds (e.g. 5% to 2% for AAA to A counterparties). Moreover, it seems doubtful whether this new calibration is based on assumptions that are consistent with the Level 1 text. The thresholds tested in QIS 3 and QIS 4 should be maintained.

#### Currency risk:

The total capital charge for currency risk is the sum of the capital charges over all foreign currencies. This is an onerous change from QIS4 since the capital charge in QIS4 was derived by testing the impact of all foreign currencies moving up or down together (and taking the most onerous result) rather than taking the most onerous result for each individual currency and then aggregating. The approach chosen in QIS4 should be maintained.

### **CP 48 – SCR Standard Formula – Non-life**

Entity specific parameters should be allowed since this was an option (which needed some refinement, however) in QIS 4.

Geographical diversification should be allowed (as in QIS4): geographical diversification by country adequately reflects the diversification benefits of (re)insurance undertakings.

Reinsurance undertakings should not be forced to use partial internal modelling to reflect the diversification benefits within the non-life underwriting risk.

Non-proportional reinsurance must be appropriately recognised in the standard formula (AMICE has developed a proposal for better recognising non-proportional reinsurance within the standard formula. This proposal is currently being assessed by CEIOPS.)

### **CP 50 – Health**

Health is not a homogenous risk: health insurance covers multiple risks such as life/non life, worker's compensation, etc. As a consequence, the segmentation proposed in this consultation paper between accident, sickness and worker's compensation lines of business is arbitrary and not appropriate for the correct operation of health activities.

Given the particular divergences (geographical and others) in this area, undertakings should be allowed to use national specific parameters and entity specific parameters to calibrate the standard deviation of premiums and reserves (e.g. the standard deviation for reserve risk of health is very low in those jurisdictions where health is a complementary-type insurance, which does not cover heavy-fat tail risks).

### **CP 51 – Counterparty default risk**

The simplification suggested for calculating the LGD as part of the standard formula should be implemented. This would help to avoid very burdensome calculations while not substantially deteriorating the quality of the outcome.

CEIOPS assumes lower recovery rates than those tested in QIS 4. No specific explanation is given for this surprising switch in assumptions. The 50% recovery rate used in QIS 4 is prudent and has been widely accepted; in the absence of any specific studies on this issue suggesting a reduction, the QIS4 rates should be retained.

### **CP 53 – Operational Risk**

The new calibration of the SCR standard formula regarding operational risk shows a significant increase in the capital requirement for this category of risk for both non-life and life undertakings:

Again, CEIOPS provides no rationale for this change of calibration. The calibration defined in the QIS 4 and the factor cap detailed in the Level 1 text should be retained. The huge difference between the factor cap proposed by CEIOPS and that indicated as a guideline in the level 1 text raises questions about the compatibility of CEIOPS' proposal with Level 1.

Any calibration must take into account the quality of the internal control procedures aiming at preventing and managing the risk.

### **CP 55 – Minimum Capital Requirement**

From the obligation to check the corridors on a quarterly basis, CEIOPS concludes that “the SCR shall be calculated on a quarterly basis”. This as such is in contradiction to the Level 1 text.

Quarterly re-calculation of SCR should only be carried out if it is required by the supervisor and if this request is justifiable (i.e. material changes which may affect the SCR). Simplifications should be allowed for carrying out quarterly MCR calculations if these are necessary.

### **CP 58 – Supervisory Reporting & Disclosure**

*AMICE has not submitted comments on CP58. However, the requirements of Pillar III are of highest importance to its members because reporting and disclosure is one of the areas where the correct application of the proportionality principle is crucial.*

*In bilateral discussions with CEIOPS and its Pillars II & III working groups, AMICE continuously highlights the serious problems arising from CEIOPS’ approach to supervisory reporting and disclosure. These are listed in an annex to this document.*

### **CP 60 – Group solvency assessment**

The definition of the consolidation perimeter for accounting purposes should be consistent with economic principles (substance over form, significant/ dominant influence, treatment of ancillary entities, ...). It is preferable to promote convergence with accounting rather than building a second set of consolidated accounts limited to the scope of group supervision.

More clarity is needed on the treatment of fungibility and transferability of the excess of assets over liabilities, and in particular regarding a portfolio’s future profit.

More guidance is needed on the methodology applicable to participations in the non-financial sector and on the scope of ring-fenced funds.

When assessing “central coordination” in mutual groups as provided for in the Level 1 Directive, supervisors should not automatically draw on the definitions of Art 12(1) of Directive 83/349. This is not directly warranted by the Directive text and it seems doubtful whether there is scope for implementing legislation on this question.

## Annex

### **CP 58 – Supervisory Reporting** (main issues highlighted by AMICE)

- Problems of quantity: an enormous amount of information is required.
- CP 58 does not indicate how proportionality is assured.
- Difficulties to assess/understand on recipient's side (policyholders).
- Wrong division between public and supervisory reporting  
(with consequences on the quantitative side [overkill] and on the qualitative side [confidentiality])
  
- Problems of confidentiality
  - Unrealistic definition of target audiences (for full public reporting)
  - Confusion of the function of prudential reporting with
    - shareholder information (company law)
    - financial market information (Prospectus & Transparency Directives)
    - client-facing information obligations
    - contractual information to bankers, rating agencies, reinsurers of the insurer's choice
  - Protection by Art 52(1) (competitive disadvantage) too weak (CEIOPS: "an exceptional event")
  
- Problems of process
  - Demanding timescale (e.g. resulting from board approval requirements etc.)
  - Duplication of reporting must be minimised between group and solo levels and with other reporting requirements
  - Problem of multiple languages in cross-border groups if the issue of group vs solo level reporting is not appropriately addressed.