

Solvency II implementation measures  
CEIOPS advice  
Third set – November 2009



AMICE core messages

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## AMICE's high-level messages with regard to the third wave of consultations by CEIOPS on their advice for Solvency II implementing measures (CP 64-77)

Summary of responses sent on 11 December 2009

### **CP 64 – Extension of recovery period - Pillar II dampener**

We generally agree with the proposal made by CEIOPS for the extension period of the recovery period.

Given that the level 2 measure is to set a maximum extension period (which can always be shortened by a specific decision), we suggest leaning towards the “longer end” of the politically acceptable spectrum and to propose a maximum period of 36 months.

For mutual and cooperative insurers it is crucial take into account the specific situation of an undertaking when assessing whether possible solutions are effectively available (with regard to the availability of external capital) to that undertaking.

Any disclosures in the context of extension periods granted require utmost discretion since they could severely deteriorate an undertaking's standing and financial position and thus directly destroy the purpose of an extension granted.

### **CP 65 – Partial Internal Models**

AMICE argues that CEIOPS paper should distinguish between the following two different situations related to the integration of partial internal models:

1. integrating partial internal model results into the standard formula;
2. integrating standard formula results into the partial internal model: This case should be treated in this consultation paper, where the PIM is close to be a full internal model. In this regard, the undertaking should be allowed to propose alternative methodologies.

Secondly, we agree with CEIOPS that the undertaking should justify the limited scope of its internal model. We also agree that supervisory authorities should retain the power to disagree with the undertakings proposed scope and reject the model, to approve the internal model with conditions and to require the undertaking to submit a transitional plan to extend the scope of the model. However, AMICE members believe that if the internal model is rejected, the undertaking must have the right to appeal the supervisory decision on the limited scope of the partial internal model.

## CP 66 – Centralised Risk Management

AMICE believes that the system proposed should be equally applicable to groups operating in one single Member State and the local supervisor should not be allowed to use stricter rules for purely domestic groups.

AMICE members also regard it essential that groups with non-vertical (i.e. horizontal or “parallel”) structures, including those that are only active in one Member State, which exist in some countries should also be allowed to use centralised risk management (and centralised systems of governance).

We argue that CEIOPS should be recognise that other forms of agreements including aspects of “domination” exist (see the “mutual group” definition on level 1 and its reference to “dominant influence”). The “power to dominate” may be assigned either to a member company of the (vertical) group or – e.g. in a horizontal structure – to a member of the group responsible for centralising the management and control of risks taken by all members.

## CP 67 – Treatment of participations

AMICE members support CEIOPS’ minority view to apply a reduced equity shock in order to take into account the likely reduction in volatility due to its strategic nature and the influence exercised by the participating undertaking. This approach is in line with Articles 109 (1) (ja) and 105(5) of the Level 1 text; CEIOPS should not therefore deviate from the Level 1 text.

## CP 68 – Treatment of Ring-fenced Funds

AMICE Members believe that a clear distinction needs to be made between

- funds where own funds are available neither in a winding-up situation nor in a going-concern situation and
- those funds where own funds are only not available in a going-concern situation.

A more favourable treatment should be applied to the latter case.

Diversification benefits should not be deducted from the total amount of own funds. Own funds can only be decreased as a result of any potential lack of transferability. Therefore, we suggest that no artificial decrease is made to the own funds to counter-act diversification effects captured in the SCR. Any reduction to diversification effects should be recognised within the SCR, not in the own funds.

It is also essential maintaining due regard to the principle of proportionality which is at the core of the solvency II process. This is particularly important for undertakings with a large number of ring-fenced funds.

### **CP 69 – Design of the equity risk sub-module**

AMICE members argue that the effect of the tougher capital requirements for equities should be thoroughly examined by CEIOPS. From our perspective, the new requirements will most certainly have a significant effect on the possibilities for insurance companies to take on equity risk. In addition to the negative effect on expected returns, there is a large possibility that the regulation will also have an impact on economic growth in all European countries, when insurance companies no longer will be able to provide the financial markets with risk capital as it happened before the crisis.

Going forward, we request CEIOPS to adopt a longer perspective, not only when evaluating the risks associated with the equity markets, but also when analysing the future role of the insurance companies as actors on the financial markets. The design of the capital requirement is far from being the single decisive factor for the resistance to a financial crisis (a good example of this the current banking crisis vs Basel II regulation), in contrast to the determinant and immediate effect that it will have on asset allocation and potential economic growth.

### **CP 70 – Calibration of the Market risk module**

The parameters used for calculation of the market risk will yield substantial larger capital requirements compared to the requirements requested in QIS 4. We would urge CEIOPS to revise the calibration of the different sub-modules.

In the interest rate risk module, CEIOPS has strengthened all the stress tests but care is needed to avoid introducing excess conservatism. More consistency is needed on the calibration of the interest rate risk: the additional introduction of a stress on implied volatility seems unnecessary – in our view, this stress was adequately included in the stress on interest rates levels in QIS4.

As mentioned in our reply to CP47, an onerous change on currency risk has been introduced 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 results. We are not in favour of this change.

There is no need of introducing more granularity in the calculations of the property risk sub-module.

We reject the new approach in the spread risk that classifies the assets on buckets per rating and maturity. This will unfairly penalise short-duration assets which would be treated as 3-year duration bonds. This simplification has no economical sense, and therefore we strongly recommend keeping the QIS 4 approach, i.e. grouping by rating and duration of the bond.

### **CP 71 – Calibration of the Non-life Underwriting Risk**

AMICE members welcome CEIOPS' initiative to disclose the methods used to obtain the calibration for the premium and reserve risk for the different lines of business. AMICE members reiterate the need to ensure that the assessment of the standard deviation for calculating the reserve risk should be based on the one-year horizon (as defined in the Solvency II Framework) and not on a full-run approach.

CEIOPS states that only 6 countries provided data for the calibration exercise. Additionally for some branches, the proposed calibration has been done with only one country. The calibration only included

some jurisdictions and thus is not representative of the European market. The new calibration proposed by CEIOPS is significantly higher than the defined calibration in QIS4 which was already considered as extremely conservative by AMICE members.

Some of the methods used are based on gross claims data and not on data net of reinsurance. Additionally we have some remarks regarding some of the methods used in the calibration and some of the assumptions defined for its application.

On premium risk, AMICE members believe that the most coherent methods to estimate the factors for the premium risk are methods 1 and 2. On reserve risk and based on the volatility calculated by line of business, we believe that the most suitable methods are methods 1 and 4. Indeed, our preferred method is method 4 since it is based on paid claims and is consistent with the size effect.

### **CP 72 – Calibration of the Health Underwriting Risk**

AMICE members would like to reiterate their position already expressed in CP50. 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 between accident, sickness and worker's compensation line of business is arbitrary and not appropriate to properly carry out health activities.

AMICE is currently working on a calibration study for the health business at the European level.

### **CP 74 – Correlations**

AMICE members believe the current financial crisis cannot be used to justify the exceptional increases of correlation factors, since the crisis has not hit the insurance sector as much as banking and financial sector (either directly or indirectly). If the underlying cause for the correlation adjustments upwards is to force the undertakings to adopt a full internal model, the discussion will be more productive for all involved parties to discuss this openly.

We agree that in many cases it is not reasonable to have a correlation factor of 0 (zero), but some suggested high correlation factors are hard to understand; they seem to be based purely on "feeling" and not on concrete evidence.

### **CP 75 – Calibration of Undertaking Specific Parameters**

AMICE members agree that there should not be restrictions on the methodologies used for the calculation of USP. We are in favor of defining general principles for applying "undertaking specific parameters" in accordance with the principles applied to the standard formula.

#### USP on Health Underwriting Risk

Some players, whose risk profile deviates significantly from the assumptions underlying the standard formula, will decide to replace a subset of the standard formula parameters by parameters specific to the undertaking.

However, undertaking specific parameters cannot solve structural deficiencies in the model as it is the case for health insurance. The proposal to introduce specific credibility factors for the Sickness Line of Business in order to take into account the characteristics of the Dutch market – highlights the inadequacy of the model, and more precisely the inadequacy of the current segmentation in the non-SLT Health module.

Social Security Systems are country-specific and since they are not harmonised, their impact differs among different jurisdictions. AMICE members therefore believe it would not be possible to have a harmonised approach on Level 2 but rather as part of the Level 3 guidance.

#### USP on Non-Life Underwriting Risk

AMICE members support alternatives 3 and 4 which are based on Merz and Würthlich (an adaptation of the Mack methodology to the one-year horizon) as the most appropriated approach for calculating the reserve risk over one year horizon.

#### **CP 76 - Simplifications for Technical Provisions**

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 pre-scribed approach and should not constitute a hard rule. In our opinion, nature and complexity should be defined following a qualitative approach and the definition of scale would resemble that of materiality. AMICE members believe that the potential use of thresholds, either absolute or relative, and the methodology for its calculation should be defined in Level 2.

The degree of model error in the measurement of technical provisions is closely linked to the reliability and suitability of the valuation. AMICE members welcome the introduction of the paragraph stating that undertakings should not be required to quantify the degree of model error in precise quantitative terms, or to re-calculate the value of their technical provisions using a more accurate method in order to demonstrate that the difference between the result of the chosen method and the result of a more accurate method is immaterial. It would be sufficient for the undertaking to demonstrate that there is reasonable assurance that the model error implied by the application of the chosen method is immaterial.

Some of the simplifications detailed in the paper are recognised as actuarial best practice in many cases and should therefore not be considered a simplification. In this regard, an undertaking should not be required to justify their application.

#### **CP 77 - Simplifications for Solvency Capital Requirement**

AMICE members argue that 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 pre-scribed approach and should not constitute a hard rule.

The list of simplifications included in this consultation paper should act as a guidance of generally accepted solutions; this would avoid an excessive burden not only on SMEs but also on undertakings with (very-)low-risk profiles irrespective of their size. Such solutions could be used to approximate the



valuation methodology which is consistent with the general principles of Solvency II. In this regard undertakings should be allowed to use alternative simplifications if deemed necessary.

AMICE members welcome the definition of scale in terms of SCR; In general terms, AMICE believes that any definition of “scale” should provide an “ex-ante” quantification of the risks of the undertaking. The scale of risks should be measured by using very simplified approaches to the SCR. If such quantification leads to the conclusion that the scale of the risks combined with their nature and complexity is small, a simplified valuation method can be applied.