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Response to Level 2 proposals

Introduction

Groupe Consultatif welcomes this opportunity to comment on the questions posed by the European Commission in relation to Level 2 draft measures and the underlying policy choices and their potential implications.

As a fully active participant in the development of Solvency II over several years, most of the questions in relation to the policy options are not new to the Groupe and our reasoned views are generally known. We have therefore answered briefly but would be happy to enlarge on these comments in any way that would be found helpful.

Although not new, we have expanded our comments on the measures in relation to the actuarial function (31-33 below). The context has changed with the implementation of EIOPA, and the Groupe looks forward to engaging with authorities and industry stakeholders to bring this element of the framework effectively into life,

Question 1: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

harmonising the calculation of technical provisions;

introducing proportionate requirements for small undertakings;

introducing risk-sensitive harmonised solvency standards; and

promoting compatibility of valuation and reporting rules with the international accounting standards elaborated by the IASB.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 meets these objectives in a more efficient and effective way and why?)

Groupe Consultatif believes that the European Insurance and Occupational Pensions Authority (EIOPA) should indeed be charged with continuous publication of discount curves in all relevant currencies for application to liquid liabilities, together with the algorithm to be used to adapt such curves for application to relatively illiquid liabilities. However, it would not be appropriate to specify in detail at Level 2 what should be the basis of such calculations as this should be able to be transparently altered regularly to meet changing market circumstances.

Groupe Consultatif, which was pleased to participate in the task force on discount rate issues which reported in March 2010, is satisfied that it was broadly appropriate to base QIS 5 on term swap rates with an adjustment for bank credit risk. The amount of the latter adjustment may have been marginally underestimated and it seems likely that the appropriate amount will vary from time to time.

While the Groupe welcomes recognition of the axiom of financial economics that liquidity characteristics (of assets or liabilities) should be reflected in economic valuation, it believes the allowance within QIS 5 to be seriously flawed. The 'illiquidity premium' should (when it is not negligible) apply to both real and extrapolated segments of the discount rate curve(s). It should also be applied to the forward rather than to the spot curve. On the other hand, QIS 5 has underestimated the liquidity of substantial elements of insurer liabilities, with the result that too high a proportion of the illiquidity premium has been applied.

The Groupe suggests that an approach allowing EIOPA flexibly to take account of market evolution and which corrects the conceptual flaws in allowing for illiquidity will greatly improve potential for consistency with IFRS.

<u>Question 2:</u> Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

harmonising the calculation of technical provisions;

introducing proportionate requirements for small undertakings;

introducing risk-sensitive harmonised solvency standards; and

promoting compatibility of valuation and reporting rules with the international accounting standards elaborated by the IASB.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 meets these objectives in a more efficient and effective way and why?)

Groupe Consultatif supports the IAA paper which addressed this issue among others (http://www.actuaries.org/LIBRARY/Papers/IAA_Measurement_of_Liabilities_2009-public.pdf pp63-112). The cost-of-capital technique is not the only possible means of determining a risk margin but it does have an intuitive logic and is in widespread use, particularly in the context of purchase or sale transactions.

We note that IFRS may allow a range of techniques to be used to calculate an appropriate risk margin for general-purpose accounting for insurance contracts. We therefore suggest that consideration be given to whether to allow a wider range for solvency accounting purposes at some point in the future.

<u>Question 3:</u> Do you agree that a 6% Cost-of-Capital rate would closely reflect the cost of providing an amount of eligible own funds equal to the SCR necessary to support the insurance obligations over the life time thereof? (Please provide reasons)

There is evidence that the cost of capital generally and in respect of particular industry sectors varies (usually) gradually over extended time periods. Groupe Consultatif would therefore prefer that provision be made for review of the relevant parameter at not more than five-yearly intervals.

Groupe Consultatif is aware of extensive academic research regarding the cost of capital but is not aware of any firm conclusion regarding differences between life and non-life insurance or by product. In our view, and only in the context of the present time, the 6% per annum rate appears to be an unbiased estimate. EIOPA would reasonably encourage continuing research in this area as an input to future reviews.

<u>Question 4:</u> Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

harmonising the calculation of technical provisions;

introducing proportionate requirements for small undertakings;

introducing risk-sensitive harmonised solvency standards; and

promoting compatibility of valuation and reporting rules with the international accounting standards elaborated by the IASB.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 meets these objectives in a more efficient and effective way and why?)

Diversification is fundamental to the economics of insurance. In the case of non-life insurers particularly, this embraces diversification across lines of business, although we share the view attributed to Deloitte that the additional benefit is small compared to diversification within a line of business. Nevertheless the Groupe finds it easy to agree that the approach envisaged by the Commission is the most straightforward.

Question 5: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing proportionate requirements for small undertakings;

introducing risk-sensitive harmonised solvency standards;

promoting compatibility of prudential supervision of insurance and banking; and

promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 or alternative suggestion meets these objectives in a more efficient and effective way and why?)

It is not possible to offer a definitive view on this question without consideration of the related issue of how certain elements of the excess of assets over liabilities – most notably what has come to be known as 'Expected Profit in Future Premiums'(EPIFP) – are to be treated.

Groupe Consultatif shares the position adopted by the Commission in relation to QIS 5 that the full excess of the economic value of assets over the consistent economic value of liabilities should count as Tier 1 (i.e. no distinction of EPIFP). If this is the case, then the Groupe tends to favour substantial coverage of the MCR requirement by Tier 1 and would readily support Option 3.

If on the other hand a significant proportion of EPIFP or of 'the winding-up gap' is not treated as Tier 1, the Groupe believes that Option 3 would become inappropriate.

Question 6: In your view, what impacts would the Commission Services' suggested approach have on the following:

cost of own funds

capital raising or capital reduction

(Please provide reasons and examples)

The answers to these questions should come from analysis in the context of QIS 5, but at the present time the Groupe is not aware of any pressure tending to change the cost of own funds or of any factor likely to prompt material capital-raising or capital reduction at the level of the industry as a whole.

Question 7: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing risk-sensitive harmonised solvency standards;

harmonising supervisory powers, methods and tools;

promoting compatibility of prudential supervision of insurance and banking; and

promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 or alternative suggestion meets these objectives in a more efficient and effective way and why?)

The Pillar II dampener is, in the opinion of the Groupe, a very useful tool to mitigate systemic risk. All other things being equal, the Groupe would favour a long maximum recovery period up to (say) 60 months in total. We assume that the desire for consistency of supervisory action is part of the reason for the Commission's preference for a shorter period, and this is understandable.

In the circumstances the Groupe is prepared to agree with the Commission. We suggest that this conclusion would usefully be supported by a provision allowing the European Systemic Risk Board (ESRB) to lengthen the maximum extension period should it deem this to be desirable.

Question 8: Should the list of factors to be taken into account by supervisory authorities when deciding whether to grant such a decision be left open? (Please provide reasons)

Groupe Consultatif agrees that an open, rather than closed, list is the more appropriate in order to afford supervisors desirable flexibility in responding to any given set of circumstances. We do not believe that this will give rise to any material risk of inconsistent supervisory action.

Question 9: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing proportionate requirements for small undertakings;

harmonizing supervisory reporting;

promoting compatibility of valuation and reporting rules with the international accounting standards elaborated by the IASB; and

ensuring efficient supervision of insurance groups and financial conglomerates.

(Please provide reasons and examples. If you do not agree, which combination of options in Annex 1 or alternative suggestion meets these objectives in a more efficient and effective way and why?)

Groupe Consultatif agrees with the view attributed to Deloitte and espoused by the Commission that Scenario 3 seems to be the most desirable.

Question 10: The Commission Services are currently of the view that, in line with the proportionality principle, the level 2 implementing measures should only require material and/ or relevant information to be provided. Do you agree with this approach? (Please provide reasons, including specific suggestions on how to implement the proportionality principle with respect to reporting requirements, how and who should determine what information is material and/ or relevant)

Groupe Consultatif believes generally that the required frequency of reporting may have regard to scale, complexity, and stability. Reports may reasonably be sought less frequently from firms which are either smaller or simpler and which exhibit stability of personnel, of business model and of financial performance.

Question 11: Do you have any suggestions on which specific quantitative data should be subject to external audit? (Please provide reasons)

Groupe Consultatif subscribes to the principle that the balance sheet (including technical provisions) should be subject to annual audit. Consideration should be given to requiring the auditor to make use of actuarial advice in relation specifically to technical provisions.

Groupe Consultatif also considers that the calculation of the MCR should be subject to annual audit.

Question 12: Do you have background information or evidence that groups are approaching the reporting requirements from a centralised, top-down group perspective? (Please also provide views on whether groups should be encouraged to adopt this approach)

No response

Question 13: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing proportionate requirements for small undertakings;

harmonizing supervisory reporting;

promoting compatibility of valuation and reporting rules with the international accounting standards elaborated by the IASB; and

ensuring efficient supervision of insurance groups and financial conglomerates.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 or alternative suggestion meets these objectives in a more efficient and effective way and why?)

Although not strictly an actuarial matter, Groupe Consultatif is supportive of the Commission view.

Questions 14: The current approach favoured by the Commission Services would be to list a number of items which would need to be put in the public domain. Some stakeholders argue that the SFCR should contain much less information, so that it is understandable by policy holders, while others support disclosure of information directed at a much wider audience. Do you have views on:

a) what stakeholders should be addressed?

b) what are the areas on which stakeholders need information?

c) how detailed has it to be?

Although we favour policyholder education and understanding, the Groupe has always believed that the effectiveness of Pillar 3 in disciplining firms will inevitably depend on proxy stakeholders – brokers, rating agencies, consulting actuaries and similar advisory firms. We favour continuing consultation of such firms in relation both to the scope of information needed and in relation to the level of detail required.

Questions 15: Solvency II will be based on an economic valuation of all assets and liabilities. The current approach favoured by the Commission Services would be to require public disclosure of a number of aggregated key figures arising from solvency valuation and their material differences with the accounting valuation. Do

you support that approach? (Please provide reasons and suggestions on how precise such information should be and how it should be presented to be understood well by markets)

Groupe Consultatif is supportive in principle of this aspiration on the part of the Commission. Experience suggests however that there can be considerable potential for confusion and that this depends to an extent on linking asset valuation differences with corresponding liability valuation differences. We favour consulting professional stakeholders on the detail of envisaged reconciliations.

Question 16: Do you consider that the approach tested in QIS5 would be the most efficient and effective in order to achieve the objectives of:

introducing proportionate requirements for small undertakings;

introducing risk-sensitive harmonised solvency standards;

promoting compatibility of prudential supervision of insurance and banking; and

ensuring efficient supervision of insurance groups and financial conglomerates.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 or alternative suggestion meets these objectives in a more efficient and effective way and why?)

No response

Question 17: Do you agree with Deloitte's conclusion that the choice of policy option may cause some undertakings to change their corporate structure? (Please provide reasons and examples)

No response

Question 18: In terms of alternative approaches for holdings in certain regulated related undertakings (financial and credit institutions and insurance and reinsurance undertakings), would you support an approach which makes use of the additional information available about these holdings to determine their contribution to the overall risk profile of the undertaking? (Please give suggestions of possible approaches)

No response

Question 19: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing risk-sensitive harmonised solvency standards;

harmonising supervisory powers, methods and tools;

promoting compatibility of prudential supervision of insurance and banking; and

promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 meets these objectives in a more efficient and effective way and why?)

Groupe Consultatif recognises the analysis attributed to Deloitte and agrees also that this is principally an issue for life insurers. We favour retaining some flexibility in order to respond to market developments. We could see value in charging EIOPA with determining an appropriate period which it might from time to time change following transparent consultation, with an overriding minimum of 12 months and an overriding maximum of 36 months.

Question 20: Is option 2 or 3 the most efficient and effective in order to achieve the objectives of:

introducing risk-sensitive harmonised solvency standards;

introducing proportionate requirements for small undertakings.

harmonising supervisory powers, methods and tools; and

promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA.

(Please provide reasons and examples)

In the view of Groupe Consultatif, Options 2 and 3 are intended to produce similar results at the level of the firm (Option 1 may be calibrated so as to produce similar results at a higher level, but not at the level of the firm). The difference is essentially one of mathematical aggregation technique, rather than of principle.

We agree that the output from QIS 5 should provide a useful picture of whether these techniques were consistently applied in practice. If satisfied on this score, then there seems to be no particular reason not to allow both techniques to continue to be used.

There are however anecdotal suggestions that many firms were not comfortable with the application of Option 3, which requires considerable care and is not easy to understand. If this option is to be retained as being available to firms, then effort of education and guidance is likely to be required. If a choice really has to be made, the Groupe would favour Option 2.

Question 21: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing risk-sensitive harmonised solvency standards;

introducing proportionate requirements for small undertakings.

promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA; and

ensuring efficient supervision of insurance groups and financial conglomerates.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 meets these objectives in a more efficient and effective way and why?)

Groupe Consultatif is happy to support the Commission Services view and also endorses the recommendation of CEIOPS that the position be reviewed when some years' experience (and data) has been accumulated.

Question 22: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing risk-sensitive harmonised solvency standards;

introducing proportionate requirements for small undertakings.

promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA; and

ensuring efficient supervision of insurance groups and financial conglomerates.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 or alternative suggestion meets these objectives in a more efficient and effective way and why?)

No response

Question 23: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing risk-sensitive harmonised solvency standards;

introducing proportionate requirements for small undertakings;

harmonising supervisory powers, methods and tools; and

ensuring efficient supervision of insurance groups and financial conglomerates.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 meets these objectives in a more efficient and effective way and why?)

Subject to consideration of what emerges from QIS 5, Groupe Consultatif tends to favour Option 3 (i.e. allowing the undertaking to seek approval to use its own techniques for partial model integration). We consider that this will encourage innovation and diversity of technique, which will reduce the level of systemic risk across the industry. We recommend that EIOPA and industry work together to assure a consistent supervisory approach to approval and we would be pleased to participate in this work.

Question 24: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing risk-sensitive harmonised solvency standards;

introducing proportionate requirements for small undertakings; and

harmonising supervisory powers, methods and tools.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 meets these objectives in a more efficient and effective way and why?)

On balance the Groupe Consultatif favours Option 2 and is an active participant in the current joint activity on factor calibration. We note and strongly agree with the point that the heterogeneity of (non-life) underwriting risk may limit the proportion of firms for whom such factors are a reasonable measure of the underlying volatility of result. The present exercise should convey a useful picture of the extent to which heterogeneity complicates matters in practice. Groupe Consultatif is a strong proponent of clear and simple approval criteria for undertaking-specific parameters as an alternative to standard factors.

Question 25: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing risk-sensitive harmonised solvency standards;

introducing proportionate requirements for small undertakings; and

harmonising supervisory powers, methods and tools.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 meets these objectives in a more efficient and effective way and why?)

Groupe Consultatif agrees with the EIOPA and Commission preference for Option 1.

Question 26: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing risk-sensitive harmonised solvency standards;

introducing proportionate requirements for small undertakings; and

harmonising supervisory powers, methods and tools.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 meets these objectives in a more efficient and effective way and why?)

Although Groupe Consultatif recognises the arguments for Option 1, it has to be acknowledged that there have been difficulties with the catastrophe risk elements of the standard formula as included in the QIS 5 technical specification.

These seemed to require data analyses which were not readily available to a substantial proportion of smaller insurers. It has also been suggested that the resulting capital requirements are much greater than the corresponding requirements operated by Lloyd's of London.

Groupe Consultatif welcomes the opportunity to co-operate with EIOPA and stakeholders in revisiting the particular problems of catastrophe scenarios.

Question 27: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing risk-sensitive harmonised solvency standards; and

harmonising supervisory powers, methods and tools.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 or alternative suggestion meets these objectives in a more efficient and effective way and why?)

Groupe Consultatif is not entirely persuaded that the options discussed here are necessarily alternatives to one another. We can recognise that Option 2 provides a very useful criterion for model approval, but we suggest it may be the case that Option 1 could also do so.

Question 28: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing risk-sensitive harmonised solvency standards; and

harmonising supervisory powers, methods and tools.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 or alternative suggestion meets these objectives in a more efficient and effective way and why?)

Groupe Consultatif agrees with the EIOPA and Commission preference for Option 2.

Question 29: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing risk-sensitive harmonised solvency standards;

harmonising supervisory powers, methods and tools; and

introducing proportionate requirements for small undertakings.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 meets these objectives in a more efficient and effective way and why?)

In the opinion of Groupe Consultatif, the fact that the SCR standard formula is intended to be appropriate for a substantial proportion of undertakings with substantially 'typical' risk profiles makes a substantial 'risk profile deviation' threshold a necessary element of the framework. Although a 'typical' profile may not be easy to define, it should be possible to recognise the 'atypical' and a difference of 10-15% seems broadly right. Groupe Consultatif therefore supports the approach envisaged by the Commission Services.

Question 30: Should supervisors be able to exercise judgment, according to pre-defined criteria, in relation to each of the following:

1) in the case of risk-profile capital add-ons, significant deviations from the SCR that are below 15%

2) for the purposes of determining when a governance capital add-on may be applied, the timeframe to be regarded as an appropriate for having allowed other remedial measures to have been exhausted, subject to a maximum period of 6 months

3) the methodology used to determine the capital add-on.

(Please provide reasons)

Groupe Consultatif is doubtful, partly for the reason stated in answer to the preceding question, as to whether consistently harmonised criteria for the exercise of such judgement can be developed. We suggest that this is another area which will justify a review of experience after Solvency II has been in force for about five years.

<u>Question 31: </u>Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

introducing proportionate requirements for small undertakings;

harmonising supervisory powers, methods and tools;

promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA; and

ensuring efficient supervision of insurance groups and financial conglomerates.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 meets these objectives in a more efficient and effective way and why?)

The Groupe Consultatif broadly supports the Commission proposal, although we believe that international actuarial associations should be given a stronger role in the development of technical standards for the actuarial function than suggested in the consultation paper, as this will help to ensure that they are appropriate and proportionate for the function. Relevant actuarial standards will in any case be developed by the actuarial profession (or specific standard-setting bodies for the actuarial profession that may exist in some countries), both at the international and national level, subject to a due process which will involve appropriate consultation with the insurance industry and with those affected by the work of the actuarial function, such as policyholders and regulators.

As expressed by IAIS, in its guidelines, “the use of actuaries as part of a supervisory model”, approved in Singapore on 3 October 2003, Conclusion #13: “The nature of the professional associations should influence the supervisor’s dependence on a responsible actuary. For instance, where professional codes of conduct, standards of practice and disciplinary procedures are in place, the supervisor may place greater reliance on these persons. The professional associations can also provide a forum for development of technical aspects of the actuarial role. In any event, the supervisor has a role to ensure that practices are adequate and subject to review.”

Some relevant standards are already in place at national level. EIOPA should have an obligation to build on such national and international standards, as would be expected for International Financial Reporting Standards, and not just ‘take them into account’, inter alia to avoid the potential for conflict with professional standards.

Some of the required guidelines are expected to be developed by the International Actuarial Association (IAA), which has established a standard-setting structure with a view to preparing generic actuarial standards for international usage, as well as specific standards for use in connection with the implementation of IFRS4 (revised). The guidelines which are more specific to the tasks of the actuarial function under Article 48 will be developed by the Groupe Consultatif under an agreement which is in place with the IAA to ensure coordination and avoid potentially conflicting standards. Both the IAA and the Groupe Consultatif will prepare standards under a rigorous due process, involving consultation not only with actuarial associations and firms but also with representatives of affected stakeholders, including EIOPA (and, in the case of IAA due process, the International Association of Insurance Supervisors and the International Accounting Standards Board).

Peter Braumüller, chairman of the IAIS, encouraged the IAA at the Council meeting in Vienna in October 2010 to perform the standard-setting task for the actuarial profession : "Having regard to the IAA's strategic objective to promote model standards of actuarial practice, I encourage the IAA Council to step up to the challenge of producing global actuarial standards to complement the global supervisory and accounting standards and to improve the transparency, reliability and comparability of the global insurance sector's financial and regulatory reporting."

Because of their professional independence, the IAA and the Groupe Consultatif are best placed to develop guidelines which are proportionate for all types of undertakings and to take into account the practical experience of actuaries in carrying out the tasks required under the actuarial function. Oversight and eventual adoption of standards by EIOPA will ensure that the standards contribute to efficient and harmonised supervision.

As regards the scope of the actuarial function (issue B), we consider that the scope is already substantially defined within Article 48 and the latest draft Level 2 measures (Article 262 SG10). Some clarification of certain aspects of the nature of the role may be required. The tasks of the actuarial function will be developed through technical standards (as referred to under issue A) and some discretion should be left to individual regulated firms as to how they implement the requirements of Article 48. This is essentially a combination of Option 1 and Option 2.

With regard to reporting, we do not consider that it is appropriate to leave the decision on the details of reporting entirely up to undertakings. Sufficient definition should be given in Level 2 measures of the required principles regarding the content, in order to ensure that a reasonable degree of consistency is achieved between firms (and member states) in the content of public reporting. The content of reporting by the actuarial function should then be the subject of actuarial standards. Internal reporting within the firm by the actuarial function could be left more to the discretion of the undertakings. We therefore favour a modified version of Option 1.

<u>Question 32:</u> Do you agree that requiring EIOPA to adopt (non-binding) guidelines at Level 3 would be the most appropriate solution in terms of practicability and level-playing-field considerations? (Please provide reasons)

Yes. This will ensure that the guidelines are accorded appropriate status by EIOPA and hence become recommended practice also for any who are not actuaries (or who are not members of national actuarial associations) who may be carrying out the actuarial function.

<u>Question 33:</u> Should actuarial guidelines solely relate to technical issues or should they be extended to include professional and ethical guidelines? (Please provide reasons)

Given the extent of discretion required in setting the Solvency II balance sheet, actuarial experience and professional integrity will be vital. We believe that it is essential for actuarial guidelines to include professional and ethical guidelines, as well as guidelines which are purely technical in nature. The dividing line is in any case not entirely clear-cut.

We suggest that it would be appropriate to amend the wording in paragraph 1 of the Level 2 measures (Article 262 SG10) to refer explicitly to "actuarial guidelines on technical, professional and ethical issues". This would also align the description more closely with that in Article 48(2) of the Solvency II Directive.

In our paper presented to CEIOPS in September 2009 we recommended as follows:

"The Groupe recommends that both public interest standards and technical standards should be formulated, in order to ensure high quality protection of policyholders and to facilitate convergence of professional practice throughout the European Union. These standards would be applicable both for actuaries and for others who may be appointed to carry out the actuarial function, and would have relevance to other actuarial responsibilities in the undertakings.

Public interest standards should include:

- qualification standards
- ethical standards
- governance standards
- communication standards

The Groupe recommends that qualification standards should include requirements for a specified minimum level of education, relevant practical experience and mandatory continuing education….

Ethical standards should cover matters such as competence, integrity, objectivity, confidentiality and avoidance of conflicts.

Governance standards should include the relationship with senior management and with the Board of the undertaking, cooperation in dealings with other internal functions and with external parties, checking and quality control of work, speaking up in case of serious concerns and protection for those who do speak up.

Communication standards might cover matters such as explanation of the purpose and scope of any report, comprehensibility, completeness, transparency, independence and accountability….

Technical implementation standards should provide broad principles on different aspects of carrying out the actuarial function. The aim should be to increase consistency of professional practice and contribute towards harmonisation and convergence of practice for all types and sizes of undertakings in the EU. They should ensure a high level of protection for policyholders, whilst not inhibiting development and innovation in the market.

Principles which might be included in the technical implementation standards include consistency, transparency and accountability, reproducibility and credibility."

Fuller argumentation of the need for public interest standards is contained within our September 2009 paper. The essential rationale is to protect the public and those who will rely upon the work of the actuarial function by ensuring that those carrying out the actuarial function are appropriately educated, experienced and up-to-date to perform the tasks required of them, and that they carry out those tasks with integrity and objectivity.

The standards should also provide guidelines relating to communications from the actuarial function and relationships with other functions and with senior management within the firm.

Question 34: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

harmonising supervisory powers, methods and tools;

promoting compatibility of prudential supervision of insurance and banking;

promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA; and

ensuring efficient supervision of insurance groups and financial conglomerates.

(Please provide reasons and examples. If you do not agree, which option in Annex 1 meets these objectives in a more efficient and effective way and why?)

Although not a professional actuarial matter Groupe Consultatif supports the Commission Services rationale for binding standards as to participation in colleges in order to avoid potential ambiguity.

Question 35: Do you share the view that provisions on colleges should not be set in level 2 implementing measures? (Please provide reasons for your response and, where relevant, suggestions on the provisions which you think should be included at level 2)

No response

Question 36: What are your views on the need for supervisors in the college to systematically exchange information? What information would be the most efficient and useful to be exchanged taking into account the potential burden for supervisors?

Supervisors should be required to share information on their plans to require solo entities within a group to submit information relating to the internal model approval process outside of the agreed group-wide internal model approval work plan.

Question 37: Do you anticipate that the Commission Services' suggested approach for level 2 implementing measures[26] would result in an increase or decrease in insurance prices? (Please provide details of the types of product or groups of policy holders affected, the magnitude of the increase or decrease expected and whether the change results from change in the value of technical provisions or capital requirements)

We see no reason why the envisaged policy choices should have any material impact on prices. Specifically recognition of the impact of liquidity characteristics on liability valuation avoids distorting the pricing of origination of illiquid annuity liabilities. Pricing of non-life business depends on calibration of the standard formula – at time of writing it would appear that the QIS 5 specification could increase prices for long-tail business.

Question 38: Would the Commission Services' suggested approach for level 2 implementing measures result in a reduction of cross-subsidisation between different lines of business or groups of policy holders? (Please provide details of which lines of business or groups of policy holders will be most affected and the reasons for this)

We see no reason why this should change. However we note that Solvency II overall has negative implications for participating life business which probably has historically depended too much on assumed feasibility of cross-subsidy.

Question 39: Would the Commission Services' suggested approach for level 2 implementing measures stimulate product innovation? (Please provide examples of the type of product innovation that is expected and details of the lines of business that this product innovation will relate to)

We doubt the Level 2 policy choices per se will much affect innovation one way or the other but Solvency II overall is broadly positive news for unit-linked business and for term assurance.

There is some risk that interpretation of the envisaged approach to contract boundaries may inhibit implementation of modern flexible contracts. Modern designs have included flexibility to raise charges usually in a manner so as not to be unfair to customers. A restrictive approach to contract boundaries could lead many firms to feel obliged to fix charges with probable disadvantage for customers and for firms' own management of various risks.

Question 40: Would the Commission Services' suggested approach for level 2 implementing measures result in a withdrawal of certain products from the market? (Please provide reasons and examples of products that may be withdrawn)

We consider it is possible that some companies may review their captive insurance operations in the light of Solvency II requirements, which are relatively onerous for captive insurance companies -please see also the response to (44) below.

Question 41: Would the Commission Services' suggested approach for level 2 implementing measures promote particular types of insurance business model (e.g. specialisation vs. diversification, joint-stock companies vs. mutuals, branches vs. subsidiaries, groups vs. single legal entities)? (Please provide reasons and examples)

Solvency 2 takes full account of the economics of diversification, and the envisaged approach to Level 2 measures reinforces this. Specialists may be at some disadvantage.

Question 42: Would the Commission Services' suggested approach for level 2 implementing measures affect competition across undertakings in the EU and/or the functioning of the internal market? (Please provide reasons and examples)

Solvency II generally is expected to make for a more competitive marketplace throughout the EU and the proposed approach to implementing measures is consistent with this expectation.

Question 43: What would the impact be of the Commission Services' suggested approach for level 2 implementing measures on small or medium-size enterprises as buyers of insurance? (Please provide examples)

Enterprises tend to depend heavily on availability of insurance, including for example various employment-related insurance products. It will be important that issues associated with calibration of the standard formula for non-life underwriting risk (including catastrophe risk) are resolved.

Question 44: What impacts would the Commission Services' suggested approach for level 2 implementing measures have on the captive market? (Please provide examples)

We consider it is possible that some companies may review their captive insurance operations in the light of Solvency II requirements, which are relatively onerous for captive insurance companies.

Question 45: What impacts would the Commission Services' suggested approach for level 2 implementing measures have on third country insurers and reinsurers? (Please provide examples)

We see no reason to anticipate any material impact, although we note concerns that have been expressed internationally in the IFRS context regarding use of discount rate bases similar to those envisaged under Solvency II for valuation of North American products.

It is possible that third country insurers may be placed at a slight advantage if, from a group perspective, less capital needs to be held in respect of an EEA insurer than if the group were domiciled in the EEA.

Question 46: What social, environmental or economic knock-on effects could occur as a result of changes to the design, pricing and availability of insurance products? (Please provide examples)

Constraints on public expenditures appear likely to carry the implication that growing proportions of health, retirement, and some other welfare costs are going to have to be met from private sources including insurance. There seems no reason at present to expect Solvency II to affect this shift.

Question 47: Would the Commission Services' suggested approach for level 2 implementing measures[27] make it easier or more difficult to obtain insurance for certain risks or groups of policy holders, and will there be a transfer of risk from insurers to consumers? (Please provide examples and where relevant, details of the risks and/ or groups of policyholders affected)

We are not aware of any reason to expect this, provided non-life and health calibration issues are resolved.

Question 48: Would the Commission Services' suggested approach for level 2 implementing measures have significant consequences for the financial situation of individuals/ households, both immediately and in the long run? (Please provide examples)

We have no reason to expect this.

Question 49: What is the impact on the social inclusion and protection of particular groups? (Please provide examples of the specific groups of individuals affected (e.g. firms, localities, the most vulnerable, the most at risk of poverty, the elderly))

Nothing to add to previous responses.

Question 50: Would the Commission Services' suggested approach for level 2 implementing measures affect some categories of consumers more than others (e.g. elderly people vs. younger people; low income consumers vs. high income; people collectively insured vs. people individually insured)? (Please provide details of the expected affects and examples)

We see no reason to expect this. The suggested approach to discount rates should assure continuing reasonable terms for those converting pension funds to fixed annuities.

Question 51: What is the impact on the access to, and effects on, social protection and health systems?

Specifically in relation to health insurance, Groupe Consultatif is a proponent of undertaking-specific parameters as a way of reflecting differences between member states' systems.

Question 52: Would the Commission Services' suggested approach for level 2 implementing measures impact more heavily specific types of health insurance products (e.g. disability insurance, long term care insurance)? (Please provide examples of the expected impact)

This should be one aspect of QIS 5 output to be analysed carefully. Disability insurance should be relatively unaffected. However, long-term care (LTC) insurance may be impacted due to the potential interaction with State benefits (which is currently under discussion in at least one member state). There is also the potential impact on LTC facilities (such as care homes) which are non-regulated. For the health SLT products the industry may see a change in reinsurance structures due to the focus on extreme events and the tail.

Question 54: What is the impact on specific economic sectors (both financial and non-financial)?

It seems unlikely that the approach to Level 2 measures will of itself have any material impact.

Question 55: Would the Commission Services' suggested approach for level 2 implementing measures impact the investment policy of insurers? (Please provide reasons and examples)

We see no reason to expect such an impact, but only time will tell. Whether investment policy is being overly influenced by the particular shape of Pillar 1 requirements will be an issue to be monitored on a continuing basis.

Question 56: Does it contribute to improving the conditions for investment and for the proper functioning of capital markets? (Please provide reasons and examples)

We see nothing in Solvency II generally or in the Level 2 policy choices particularly which interferes with the smooth functioning of markets.

Question 57: Would the Commission Services' suggested approach for level 2 implementing measures contribute to financial stability? (Please provide reasons and examples)

Stability has been a significant consideration underlying many of our earlier comments. We believe it very important that the Level 2 choices should embrace sufficient flexibility to avoid shocks while at the same time remaining capable of consistent harmonised implementation.