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CEIOPS' Advice on Solvency II Level 2 implementing measures – first and second set

Dear M. Holmquist,

Following your letter of 12 June 2009, in which you asked CEIOPS to deliver final advice on the vast majority of areas covered in the first and second round of consultation by October 2009, I am pleased to submit to you the final advice adopted during CEIOPS Members' Meeting held on 29 and 30 October 2009.

Two consultations were held on 37 papers from March to September 2009. CEIOPS received more than 3.600 comments during the first wave (CP 26 – 37) and close to 20.000 comments during the second wave (CP 39 – 62). Comments were submitted by national and European associations as well as by individual insurance undertakings. 11% of the submissions came from stakeholders other than (re)insurance industry, such as academia, consultants and lawyers, showing the increasing interest in the Solvency II project.

CEIOPS has embraced a transparent and successful process in resolving the issues raised, where the dialogue with the relevant stakeholders has assumed an increasingly important role. Several meetings were held at an institutional level and at a more technical level. This dynamic process has allowed CEIOPS to revise and improve its advice with due consideration to comments received.

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As you know, stakeholders raised a number of comments in relation to CEIOPS' interpretation of some provisions of the Level 1 text. The Commission has also sent CEIOPS a short, informal list of seven issues where it believes the draft advice was not fully aligned with the Level 1 text. CEIOPS has carefully considered the list and has provided solutions to ensure its advice is in line with the Level 1 text. For example, CEIOPS has changed its final advice with regard to the cap for the operational risk charge or the requirement on capital instruments' substantial fulfilment of the criteria for the classification into tiers,

Where CEIOPS strongly believes that the Level 1 text allows for other interpretations, this was mentioned in the advice providing, however, to the extent possible, alternatives to ensure consistency with the Commission's approach. This could help to inform the discussions that will occur at the political level. In other areas, the implications of such amendments in the various pieces of advice need careful thought and analysis. In particular, this applies to the treatment of future premiums in the calculation of the best estimate, where CEIOPS would appreciate guidance from the Commission on the criteria for the treatment of future premiums. In light of such guidance, CEIOPS stands ready to do further work, namely on the consequences for own funds and SCR.

Specifically with regard to technical provisions, CEIOPS believes that there are valid arguments for its line of thinking concerning the choice of the reference rate for the risk-free discount rate. CEIOPS has proposed criteria that have to be met in order to be consistent with a risk-free rate, and stands ready to work on the harmonisation at European level of the adjustments needed to achieve these criteria for relevant instruments. Although the choice of the reference rate is a technical issue, CEIOPS recognises that, due to the level of quantitative impact on the level of technical provisions, this has strong political implications. This applies, in particular, to the inclusion of an illiquidity premium in the risk-free rate. Hence, further work would have to be carried out with a clear concept and mandate in light of the framework contained in the advice. CEIOPS is prepared to take the lead in this area and continue to involve all the relevant stakeholders in a transparent process.

There are other areas where CEIOPS has taken the main stakeholder concerns on board. I would like to refer to the summary feedback statement in which CEIOPS has sought to summarise revisions made following key comments from stakeholders. Two examples:

- On disclosure, while emphasizing the importance of transparency as a basic building block of Solvency II, CEIOPS adjusted its advice in order to take into account more explicitly the importance of materiality and the principle of proportionality. CEIOPS reduced some details on disclosure around risk mitigation and issues around the administrative or management body. Furthermore, in order to facilitate the transition to Solvency II, CEIOPS proposes a scaling-down of the deadlines for reporting and disclosure.
- In relation to groups, most of the concerns arose from misunderstandings, which CEIOPS aimed to clarify. CEIOPS has highlighted that the consolidated method is the default method of the

Level 1 text and that it did not intend to question this. Furthermore, CEIOPS underlines that the equivalence of the third country regime is not the only issue to consider when assessing diversification at group level. As regards the criteria to assess equivalence, CEIOPS will publish, at the beginning of December 2009, a draft Cconsultation Paper.

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Further, in line with a previous request from CEIOPS' Members to look at lessons to be learned from the crisis CEIOPS has ensured some of these lessons would be taken on board in its advice

One of the lessons concerns own funds. CEIOPS strongly believes in the need for high quality capital, which has been confirmed in the recent statements of the Financial Stability Board (FSB) and the G20 Summit. While CEIOPS recognises that banking and insurance have quite different business models, we believe that, in this area, cross-sectoral convergence, in particular in relation to the basic principles, cannot be ignored. Hence, CEIOPS sees the quality of capital as a crucial element for a solid Solvency II regime. Consequently, while recognizing some hybrid instruments as eligible, CEIOPS insists on the need to focus on the loss-absorbing capacity of the instruments, rather than on their name, and recommends that political discussions should take into account the parallel developments in the other sectors in order to avoid future regulatory arbitrage.

Lessons from the crisis also cover the treatment of risks (e.g. credit, market, concentration, operational), the need for stress testing and the robustness of internal models. CEIOPS has duly considered which of these lessons should be drawn for the future Level 2 implementing measures. Accordingly, in its draft advice on calibrations and correlations, it has based its analysis on available evidence in order to ensure that the correct calibration of a 99.5% SCR is achieved. CEIOPS would appreciate specific stakeholder feedback regarding the analysis and evidence presented.

Finally, I would like to assure you that CEIOPS stands ready to contribute in any way you consider useful to the discussions on the Level 2 implementing measures, namely through participation in the future meetings of the EIOPC and its Solvency Expert Group.

Yours sincerely,

Gabriel Bernardino

CEIOPS Chair