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Summary of comments on CEIOPS-CP-28/09	CEIOPS-SEC-92/09
Consultation Paper on the Draft L2 Advice on SCR Standard Formula - Counterparty default risk	

CEIOPS would like to thank **AVIVA, PEARL GROUP LIMITED, International Group of P&I Clubs, FFSA, ROAM, International Underwriting Association of London (IUA), German Insurance Association – Gesamtverband der Deutschen Versicherungswirtschaft (GDV), European Union member firms of Deloitte Touche Tohmatsu, DIMA (Dublin International Insurance & Management Association), Lloyd's, Dutch Actuarial Society – Het Actuarieel Genootschap (AG), Centre Technique des Institutions de Prévoyance (CTIP), XL Capital Group (including XL Insurance Company Ltd and XL Re Europe Ltd) ("XL"), UNESPA (Association of Spanish Insurers), KPMG ELLP, Munich Re, CRO-Forum, ASSOCIATION OF BRITISH INSURERS (ABI), European Captive Insurance and Reinsurance Owners' Association (ECIROA), PricewaterhouseCoopers LLP UK, Institut des actuaries, Groupe Consultatif, CEA**

The numbering of the paragraphs refers to Consultation Paper No. 28 (CEIOPS-CP-28/09).

No.	Name	Reference	Comment	Resolution
1.	AVIVA	General comment	Overall we see the proposals as a significant improvement on the QIS4 position. We particularly support the splitting of Type 1 and Type 2 exposures, and the fact that there is some simplification to the Type 1 calculation. However we still believe the Type 1 calculation is disproportionately complex and could be simplified further.	Noted. Simplifications are dealt with in CP 51
2.	PEARL GROUP LIMITED	General comment	We welcome this opportunity to comment on CEIOPS' Level 2 advice on the SCR standard formula – Counterparty default risk. We welcome CEIOPS' recognition that the method of calculating the counterparty default risk module needs to be addressed. This is a significant area for insurers and needs an appropriate method of assessing this risk. The method proposed is better than the approach used in QIS4, but it is hard to see how it might behave in practice as it is as yet uncalibrated. Apart from the likely values of the parameters themselves, we are concerned that the difficulty of internal reinsurance does not seem to be addressed anywhere in the paper. Concerns linked with this include	Calibration and ratings are dealt with in CP 51

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			how to rate an internal reinsurer and what the corresponding default assumptions and loss given default values may be in this situation.	
3.	International Group of P&I Clubs	General comment	The International Group of P&I Clubs (the IG) is supportive of the proposals set out in CP 28 [and 31], but has the following comments on the Consultation Papers (plesae note that there is a degree of overlap with our commnets on CP31 and CP28):	Noted.
4.	FFSA	General comment	At first, we regret to see only a little part of the subject dealt with in the consultation paper. Indeed, all the parameters and calibration details has been left out of the consultation. Therefore, it is difficult to assess the real impact of the formulas described. Our comments below are subject to advices made in the consultations dealing on the same item. That said, FFSA is glad to see that supervisors seem to be willing to simplify the calculation of the SCR counterparty default risk (CDR) which seems to be simpler as it is described in the draft advice than was is in the QIS 4 technical specifications. However, the calculation methods seem to be, in our concern, still too much complex in regard to its materiality for insurance undertakings. Indeed, QIS4 French results showed that **the counterparty default risk is not material** for life undertakings (0% of the SCR) as for non life undertakings (5% of the SCR). This doesn't justify such a complex and fastidious calculation. That is why FFSA is in favor of simplifying more further the calculation and is waiting for CEIOPS' answer on its consultation (9th January) concerning new methods proposed in order to simplify the calculation of the Loss Given default (LGD), especially when there are a large number of counterparties.	Calibration and simplifications are dealt with in CP 51.

			One of the reasons of this complexity is in the calculation of the risk mitigation effect (RM) which assessment is very demanding especially because of the need a recalculation of the affected SCR module as mentioned in paragraph (3.52) of the consultation. A possible and simple solution would be to allow a simplification where the entity replaces this parameter by the difference between the value of the exposure before and after the stress.	
5.	FFSA	General comment	In an Economic logic, the capital charge regarding an exposure to a (re)insurer under Solvency II regime which covers its SCR should be set at nil. Indeed, whereas the creditor is controlled and has, at least, a default probability of 99.5%. FFSA believes that the exposure should be charged only when the counterparty doesn't cover its SCR.	Not agreed. The argument seems only to be valid in very special cases. For example, the 99.5%-VaR of a bouquet of several independent counterparties with a 0.5% probability of default each is not nil.
6.	ROAM	General comment	At first, we regret to see only a little part of the subject dealt with in the consultation paper. Indeed, all the parameters and calibration details have been left out of the consultation. Therefore, it is difficult to assess the real impact of the formulas described. Our comments below are subject to advices made in the consultations dealing on the same item. Regarding the parameters, we request details about the calibration as soon as possible The calculation method is too complex in regard to its materiality for insurance undertakings, in particular for type 1 exposure. One of the reasons of this complexity is in the calculation of the risk mitigation effect (RM) which assessment is very demanding especially	Calibration and simplifications are dealt with in CP 51.

			because of the need of a recalculation of the affected SCR module as mentioned in paragraph (3.52) of the consultation.	
			A solution could be: for the rated risks use a board of coefficient and for the unrated risks use the formula proposed by CEIOPS for the type 2 exposures.	
7.	ROAM	General comment	Interaction with spread risk module - Any comments made on CP28 should also be assessed when any implementing measures are published relating to the "spread risk" module, as the two modules should be assessed in conjunction with each other. We also expect that there will be further clarification with respect to what risks (and what instruments) are covered in the two modules, to ensure there is no double counting. Particularly, the treatment of derivatives should be detailed: the calculation of risks linked to CDOs, ABS, direct derivative products, structured products included in classical bonds, SPVs should be specific.	Noted. See section 3.2.1 of the CP.
8.	IUA	General comment 1	We are supportive the segmentation between Type 1 and Type 2 risks, and we broadly feel that the methodology outline represents an improvement over the QIS 4 methodology. We keenly await further guidance, and the calibration to provide the necessary further detail on this framework.	Noted.
9.	IUA	General comment 2	We are pleased to see that some of the issues arising out of QIS 4 have been addressed in this paper.	Noted.
10.	IUA	General comment 3	We believe that any approach for counterparty default risk should be proportionate, and not overly burdensome. Certain treaty contracts	Simplifications are dealt with in CP 51.

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		Annex B5 – B11	will have multiple layers (where each layer covers losses between set levels, often so that they "stack" up to an overall limit for the cedent's reinsurance programme). Furthermore, each layer might be written by a number of counterparties (subscribers). It is not unusual for reinsurance treaties to have up to seven layers, and multiple subscribers on each layer. Every counterparty on such a risk is severally liable, but their liability is not joint. In other words, in the event of a default, each counterparty is only liable for their own share. We would suggest that calculating the counterparty risk default risk should not be overly burdensome to calculate, particularly where there are multiple counterparties.

In reference to the above, it is unlikely all subscribers, and participants will have the same rating, or loss-given-default. | |
| 11. | IUA | General Comment 4 | The use of an approach as proposed could have pro-cyclical consequences. A downgrade for a participating counterparty will inevitably result in an increase in the capital requirements for the cedent. If a downgrade clause exists, it could result in the renegotiation of that participant's part of a treaty, or state a requirement to post security. Consequently, the loss of business (or the requirement to post security) could further weaken the capital position of an institution. We are unclear how such an issue could be addressed, but we do believe issues of pro-cyclicality need to be considered so that where possible, a downgrade does not necessarily become self-reinforcing. | Not agreed. This pro-cyclical effect appears to be inevitable if the risk measurement is based on the current credit standing of the counterparties. The alternative, namely to assume a fixed probability of default for each counterparty, lacks risk-sensitivity. |
| 12. | GDV | General comment | **The GDV supports the comments given by the CEA.**

In particular we would like to emphasize the following issues: | Calibration and simplifications are dealt with in CP 51. |

			The segmentation between counterparties of type 1 and type 2 is appropriate.	
			However, the counterparty default risk module remains disproportionally complex due to the required calculations for each counterparty of type 1. This computation needs substantial simplifications.	
			In principle, the factor approach for type 2 counterparties seems feasible although the calibration of the parameters x and y is crucial. This calibration is still missing.	
			Moreover, possible interactions with the spread risk module have to be taken in account.	
13.	Deloitte Touche Tohmatsu	General comment	Overall we welcome the advice proposed in this consultation paper. In particular, we agree with the approach of introducing a split between the two types of exposure, as it will enable the calibration to reflect the differences in the nature of these two types of risk. However, we believe that further refinements may need to be considered (perhaps as part of Level 3 guidance) in respect of "type 1" exposures as the proposed methodology is relatively complicated, and may result in firms who are using an internal model finding it difficult to make a direct comparison between the output of the internal model and that of the standard formula.	Noted. Calibration is dealt with in CP 51. Agreed. A spreadsheet for the calculations can be provided.

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			Given the complexity of the proposed formula, we recommend that a tool such as a pre-programmed spreadsheet is developed and issued to firms for population, in order to mitigate the risk of inconsistent or incorrect application of the standard methodology. Finally, the effectiveness of the revised approach is difficult to assess in an abstract fashion. We recommend that a quantitative exercise is commissioned by CEIOPS in order to: - confirm that the new formula for "type 1" exposures works effectively, and identify any remaining issues; and - optimise the calibration of this part of the Standard Formula.	
14.	DIMA	General comment	This is clearly a high level paper which is less developed than most of the other consultation papers. A number of crucial issues remain to be decided: 3.62: Probability of default / rating class; 3.64 Calibration of parameters used in the calculation of the capital requirement. These uncertainties make comments /suggestions on the current consultation paper more difficult. Also, no distinction between direct insurance and reinsurance is made, although the nature of counterparties can be quite different. No distinction seems to be made between counterparty risk for EU and non-EU counterparties (which may be subject to different levels of	Rating of counterparties, calibration and simplifications are dealt with in CP 51.

			legislation and regulation than commonly found in the EU).	
			General concern is that so many open issues still need to be decided with respect to this consultation, which raises the question whether the proposed timelines can be met.	
15.	Lloyd's	General comment	Lloyd's welcomes the revision to the counterparty default risk element from the version proposed in QIS4.	Noted. Ratings and calibration are dealt with in CP 51.
			The consultation paper proposes treating default risk in two tranches; type 1 exposures that cannot be diversified (such as reinsurance and broker defaults) and type 2 exposures that are more diversifiable (such as policyholder debts). This is a positive step forward since it will allow, subject to the final calibration, for the different features of these two sources of credit risk.	A spreadsheet for the calculations can be provided.
			The proposed method for dealing with type 1 exposures appears to be reasonable, although (necessarily) computationally complicated. As noted in appendix A14, the calculation can be easily implemented in a spreadsheet, and therefore we would suggest that the standard formula is pre-programmed by CEIOPS so that there are no issues with inconsistent and incorrect calculations by different companies. It should be recognised that the complexity of the computations may make direct comparisons to internal models difficult.	
			The proposed methods are heavily dependent on the calibration of the assumptions and this has not been addressed in the consultation paper. This makes absolute support for the proposals difficult without more detail. We would expect consultation on proposals for calibration of the methods.	
			As noted in the consultation paper, both historically and as the	

			proposals currently stand, there is a substantial reliance on credit ratings which may cause some concern and introduce additional risk to the process. CEIOPS should consider how to address this challenge which may involve an interim "mini-QIS" to help develop calibrations and approach.	
16.	XL Capital Group	General comment	XL welcomes the opportunity to comment on CEIOPS' draft advice on SCR Standard formula – Counterparty risk module". (CP No. 28).	Simplifications and ratings are dealt with in CP 51.
			We are pleased to see that the QIS 4 approach to counterparty default risk, which we noted as being unduly onerous, has been addressed in this paper. There has been a complete overhaul of how the capital requirements for the Type 1 exposures (which include reinsurance) are calculated. The Herfindahl index has been abandoned for counterparty risk. This is likely to change materially the shape of the SCR result for counterparty risk from that calculated in QIS 4. As such we would recommend that the proposed approach be thoroughly tested and calibrated.	
			The proposed approach appears more complex than the QIS 4 approach, and we are uncertain how proportionality will be applied in the practical application of this method.	
			We would also like to see further guidance regarding how the proposed approach caters for internal reinsurance.	
17.	UNESPA	General comment	At first, we regret to see only a little part of the subject dealt with in the consultation paper. Indeed, all the parameters and calibration details has been left out of the consultation. Therefore, it is difficult to assess the real impact of the formulas described. Details of the calibration are requested as soon as possible (level 2).	Simplifications and calibration are dealt with in CP 51.

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			This being said, we are glad to see that supervisors seem to be willing to simplify the calculation of the SCR counterparty default risk which seems to be simpler as it is described in the draft advice than was is in the QIS 4 technical specifications. However, the calculation methods seem to be, in our concern, still too much complex in regard to its materiality for insurance undertakings. Indeed, QIS4 results showed that the counterparty default risk is not material for life undertakings as for non life undertakings. This doesn't justify such a complex calculation. That is why we are in favour of simplifying more further the calculation, especially when there are a large number of counterparties (type 1 exposures).	
18.	KPMG ELLP	General comment	Overall we feel that the draft advice as detailed in this consultation paper may be too prescriptive. We believe the full specification for the model to calculate the SCR for counterparty risk should be specified at a lower level or left to be set out in technical standards. This will provide greater flexibility: - In response to changes in the economic environment and markets - In response to new products and business models where the profile of risk arising from counterparty exposures may not be adequately captured - In response to changes in the legal environment which can impact on the ability to enforce claims to counterparties and therefore the risk from counterparty exposures.	Not agreed. CEIOPS believes that the SCR standard formula should be specified in the Implementing Measures of the Framework Directive.
19.	Munich Re	General	We support the comments devised by the CRO Forum to CP 28.	See resolution of comment 20.

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		comment	Additionally we would like to emphasise the following: • We would like to see the robustness of this new methodology be tested in the QIS5 exercise. • We welcome the simplification of the counterparty default risk module. • There should be a consistent treatment across all exposures.	Agreed. The methodology should be tested in QIS5.
20.	CRO-Forum	General comment	The updated proposal for assessing counterparty default risk solves several shortcomings of the QIS4 approach. Nevertheless, it is difficult to assess the impact of the changes as calibration parameters are not included in this CP. We definitely think that the robustness of this new methodology should be tested in the QIS5 exercise. We welcome the choice of CEIOPS to simplify the counterparty default risk module. The trade-off between precision and simplicity can, however, be further improved, as is stipulated in the counterparty default risk section (chapter 7) of the CRO-Forum calibration principles paper. Especially the calculation of the loss given default for the individual counterparties could be further eased without losing too much precision. In addition, we believe that it would increase consistency across exposures and transparency of the standard formula to remove the split between type 1 exposure and type 2 exposure. Instead, we propose to open the standard formula to company internal ratings for unrated exposure.	Noted. Agreed. The methodology should be tested in QIS5. Simplifications, ratings and calibration are dealt with in CP 51. Not agreed. CEIOPS believes that internal rating approaches are not within the scope of the standard formula.
21.	ABI	General comment	The ABI welcomes this opportunity to comment on CEIOPS' Level 2 advice on the SCR standard formula – Counterparty default risk.	Noted. Simplifications, ratings and calibration are dealt with in

				CP 51.
			We welcome CEIOPS' recognition that the method of calculating the counterparty default risk module needs to be addressed. This is a significant area for insurers and needs an appropriate method of assessing this risk. The method proposed is better than the approach used in QIS4, but it is hard to see how it might behave in practice, as it is as yet uncalibrated. The ABI suggests that the extensive work done behind the scenes for Basle 2 be used as a basis for the calibrations of the parameters. We are also prepared to help in any way possible with the work that this may require, although we understand that CEIOPS has already started this endeavour. Nevertheless we are supportive of the splitting of Type 1 and Type 2 exposures.	
			Apart from the likely values of the parameters themselves, we are concerned that the difficulty of internal reinsurance does not seem to be addressed anywhere in the paper. Concerns linked with this include how to rate an internal reinsurer and what the corresponding default assumptions and loss given default values may be in this situation.	
			We are concerned that whilst this improves on the method used in QIS4, this method may be too complex and time consuming in proportion to the risk it represents. We believe that a quantitative impact study should be used to test this method once the parameters have been established before it is adopted.	
22.	ABI	General comment	The ABI welcomes this opportunity of commenting on CEIOPS' draft advice on the new method for evaluating counterparty default risk. Whilst we believe that this improves on the method used in QIS4, we are concerned that this method may also be too complex and time consuming in practice and that it is not proportionate to the risk it represents, i.e. the time and effort taken to value this module is not in proportion to the amount of capital that it represents. We believe that	Simplifications, ratings and calibration are dealt with in CP 51. Agreed. The methodology should be tested in QIS5.

			the trade-off between precision and simplicity can be further improved. Furthermore, without any more details on the parameters that are used in this method, it is difficult to evaluate the accuracy of the model. We believe that if Solvency II can learn from the extensive work done on this area during Basle 2 on credit risk, huge gains can be made in both understanding and modelling this risk. We would like to engage early on with CEIOPS in their discussions on the thresholds, parameters, factors, rating classes and risk factors involved in an evaluation of counterparty default risk. We believe that the industry has a valuable contribution to make in these areas before any permanent decisions on values are made. The current proposed method does not seem to cater for internal reinsurance and the way in which its rating may be calculated. We also have some questions as to the assumptions on the distributions used in this method. Finally, we would recommend a quantitative impact study to test this method once all the parameters have been established before it is implemented. The robustness of this new method could be tested in the QIS5.	
23.	ECIROA	General comment	Most captives are primarily very small companies and are usually serviced by professional licensed captive management companies and insure the risk of their own group. ECIROA recognises that there is a need to quantify counterparty default risks. However ECIROA asks that full consideration should be granted under the proportionality principle due to the following facts: 1. Captives do not (re)insure huge amounts to cover a full portfolio. 2. A captive is writing risks of its own group and thus there is no need to protect a 3rd party insured; the Counterparty default risk would	Simplifications are dealt with in CP 51. Further advice on simplifications for captives will be consulted at a later stage.

| | | | impact only the Insured who is identical with the Captive Owner.
3. A direct insurance company knows who it is doing business with and does not service a captive should this not be creditworthy.
4. Often insurance contracts where a captive is one party include a simultaneous payment clause.

The question of counterparty default risk module calculation is made up of two issues for captives. Firstly, due to the simple structure a small undertaking like a captive has a proportionate less amount of counterparties, for example number of banks. Secondly, most captives are unrated and therefore captive business will demand a higher capital for ceding companies. ECIROA believe that this does not reflect the real risk and further sees a substantial increase in requests of costly collaterals

ECIROA has been writing to all major European insurance companies to ask for support in this matter (support and acknowledgement have also been received) and hereby asks CEIOPS to fully consider the facts above in the development of simplifications for captives. ECIROA is looking forward to the release of a consultation paper on such simplifications. | |
| 24. | Pricewaterho useCoopers LLP UK | General comment | • The module outlined in CP28 is an improvement from QIS4, particularly around the separate consideration of unrated entities. However, the proposed calculation, whilst simpler than that in QIS4, is still complicated and we have concerns over whether all insurers will be able to understand and follow it.
• Additional guidance is required on the allowance of Risk Mitigation within the counterparty risk calculation, particularly as there is a lot of scope for use of judgement; this makes it difficult to ensure consistency across firms, territories etc. | Noted.

See CP 12. |

25.	Institut des actuaries	General comment	Institut des actuaires, the third European actuarial local association, representing 2300 actuaries from France, is keen on commenting the Consultation 28-09 which begins the SCR level 2 construction.	Noted.
26.	Groupe Consultatif	General comment	- From a theoretical point the proposed approach appears to be more robust than that used in QIS4. The main point being that for type 1 exposures QIS4 methodology assumed a high number of homogeneous exposures whereas the proposed methodology in CP28 emphasises the heterogeneous nature and limited number of exposures. - However, whist the example provided in the CP are stated not to be the final calibration it appears likely that high capital requirements will result for the proposed method compared to QIS4 if the insurer is mainly exposed to highly rated counterparties. - Overall we believe that the draft advice as detailed in this consultation paper is too prescriptive. The full specification for the model to calculate the SCR for counterparty risk should be specified at a lower level or in technical standards. This will provide greater flexibility: • In response to changes in the economic environment and markets • In response to new products and business models where the profile of risk arising from counterparty exposures may not be adequately captured • In response to changes in the legal environment which can impact on the ability to enforce claims to counterparties and therefore the risk from counterparty exposures.	Noted. Calibration is dealt with in CP 51. Not agreed. CEIOPS believes that the SCR standard formula should be specified in the Implementing Measures of the Framework Directive.

			- The approach for type 1 exposures includes allowance for the fact that the probability of default changes with the size of the LGD.	We do not understand this comment. The probability of default and the LGD are independent input variables of the calculation.
			- This approach does not capture the counterparty risk arising from exchange traded instruments. In this case there is no single identifiable counterparty. The risk falls on entities such as clearing houses and exchanges. In a 1 in 200 year scenario a failure of the exchange is a possibility.	Agreed. See revised text.
			- The loss given default calculation should include any compensation that maybe available from industry wide compensation schemes. Perhaps this should be included in the recovery rate calculation.	Not agreed. These compensation schemes usually only protect the policyholder, but not other creditors.
			- For type 1 business the valuation of the LGD includes "RM" which is the risk mitigation effect on underwriting risk of the reinsurance arrangement or SPV securitization (i.e. difference between the capital requirement for underwriting risk without the reinsurance or SPV securitization and with it). This element of the calculation of the LGD is included in the reduction to allow for the recovery rate assumption. The definitions in 3.47 onwards are confusing and we can envisage situations where the "RM" component should not be included within the amount reduced by the recovery rate assumption, i.e. would not expect the reinsurer to be liable for this additional capital. Further clarification on how this formula should be applied in practice would be very useful.	The sum Recoverables + RM is to be understood as a (stressed) exposure at the time of default of the reinsurer. The recovery rate applies to the whole exposure. Further advice on the calculation of RM can be found in CP 51.

				- This calculation does not give any consideration to the time of the recovery. In practice there is likely to be a protracted period from the event of default to the eventual settlement of the counterparty's creditors.	Partly agreed. The possible time lag relating to the recovery of the counterparty should be reflected in the calibration of the recovery rate. See revised text in further advice on CDR (former CP51)

				- Related to the point above, the approach assumes that in the stressed scenario the risk is brought back onto the balance sheet rather than placed with another counterparty (if this was assumed the capital requirements would be the assumed rates upon which it could be place in the stress conditions and the costs of arrangement).
				  - Further consideration should be given to the nature of the undertaking's debtors. For example there are other sources of counterparty risks such as custodians and clearing houses. The risk is also influenced by factors such as whether the regulatory environment requires the client's assets (in this context the assets of the undertaking as client of the counterparty) to be segregated for example.
				  - Where segregated assets are held, this can improve the recovery in a default situation. The nature of the legal environment, the contracts, the structure of the counterparty, etc all have significant impacts on the recovery from a default.
					Not agreed. CEIOPS holds the view that the modelling of these details are unlikely to be within the scope of the SCR standard formula.

				- We suggest that consideration be given to classifying financial reinsurance under credit risk. Here the primary purpose of the reinsurance is to provide financing rather than provide a risk mitigating effect.	Not agreed. Reinsurance is under the scope of the counterparty default risk module according to Article 105(6). A separate

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				treatment could give rise to arbitrage opportunities.
			- Currently there is no diversification allowed between type 1 and type 2 counterparty risks. However we believe that this should be considered particularly if the underlying model for calculating the SCR for type 1 and type 2 risks does not have an allowance for this.	Agreed. See revised text.
			- It is unclear how this approach would operate for unrated entities. While the CP does suggest that the counterparty in a type 1 exposure is likely to be rated, this does not necessarily need to be the case.	Ratings and calibration are dealt with in CP 51.
			- There are large parts of the module undefined or vaguely defined including the calibrations.	
			- In the absence of final calibrations it is hard to know how this new model will impact the SCR of individual companies. It would be good to get these calibrations as soon as possible so that companies can test the impact the model will have on its SCR and comment on the suitability of the model.	
27.	CEA	Introductory remarks	The CEA welcomes the opportunity to comment on the Consultation Paper (CP) No. 28 on SCR standard formula - Counterparty default risk module.

It should be noted that the comments in this document should be considered in the context of other publications by the CEA. Also, the comments in this document should be considered as a whole, i.e. they constitute a coherent package and as such, the rejection of elements of our positions may affect the remainder of our comments. | Noted. |

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Summary of comments on CEIOPS-CP-28/09   CEIOPS-SEC-92/09

**Consultation Paper on the Draft L2 Advice on SCR Standard Formula -
Counterparty default risk**

			These are CEA's views at the current stage of the project. As our work develops, these views may evolve depending in particular, on other elements of the framework which are not yet fixed.	
28.	CEA	Key comments	**Clarification is requested on the thresholds between type 1 and type 2 risks** The segmentation into type 1 and type 2 risks is good step forward, however, we request further clarification on the thresholds to apply to split counterparties between type 1 and type 2 exposures. **The calculations are too complex** We are concerned that the calculations need substantial simplification, particularly in relation to the LGD where there are a large number of counterparties. **The details of the calibration are requested as soon as possible** The absence of calibration (or description of the methodology to be used to calibrate the formula) makes it difficult to comment on appropriateness of capital requirement.	The calibration of the threshold is dealt with in CP 51. Simplifications are dealt with in CP 51. The calibration is dealt with in CP 51.
29.	CEA	General comments	**Segmentation of type 1 and type 2 risks -** There is general agreement that the segmentation of type 1 and type 2 risks is good step forward and this segmentation has been well received by undertakings. Further clarification is still required on the thresholds to apply in the split between type 1 and type 2 exposures.	The calibration of the threshold is dealt with in CP 51.

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				The new approach appears to improve on the QIS4 approach by offering incentives for diversification of counterparty default risk for type 1.	Noted.
				The simplified approach to Type 2 risks is also welcome, and in general appears proportionate to the risks involved.	Noted.
				Complexity of calculations – The CEA expresses a strong view that the calculations need substantial simplification, particularly in relation to the LGD where there are a large number of counterparties.	Simplifications are dealt with in CP 51.
				The CEA response to CEIOPS paper on LGD outlined suggested simplifications to the calculation of LGD which we understand that CEIOPS are happy to include in the Level 2 advice, however, they were not included in this advice. The CEA would encourage CEIOPS to include these simplifications in further advice.	
				We understand deterioration in credit standing (or downgrade) is implicitly considered - The CP assumes that the only reduction in net asset value in respect of credit risk on reinsurance and derivative counterparties relates to default within the 12 month time horizon of the SCR calculation. Article 80 of the Framework Directive requires that, in assessing the value of amounts recoverable from reinsurers for the technical provisions, adjustments be made to reflect the probability of default and the loss given default in respect of reinsurance counterparties. Adverse events may increase this prospective adjustment to the amounts recoverable from reinsurers even if no default has occurred, i.e. from downgrade. This risk is currently not explicitly mentioned in the counterparty default risk sub-module. We	The risk of a downgrade is implicitly included in the approach. See revised text.

			assume that this risk has been implicitly allowed for in the illustrative calibration parameters. However, it is not clear that this risk could be rigorously allowed for in the calibration of the proposed "ter Berg" model, as this is driven by default rather than downgrade probabilities.	
			Interaction with spread risk module - Any comments made on CP28 should also be assessed when any implementing measures are published relating to the "spread risk" module, as the two modules should be assessed in conjunction with each other. The CEA also expects that there will be further clarification with respect to what risks (and what instruments) are covered in the two modules, to ensure there is no double counting.	See section 3.2.1 of the CP.
			Interaction with recoverables in art 80 - The counterparty default risk is dealing with "unexpected default". This is directly interlinked with the "expected default", mentioned in articles 80 ("Recoverables from reinsurance and SPVs). There is not yet a consultation paper on the "expected" default for above mentioned recoverables which could help in deriving a clearer basis for a consultation of the "unexpected default".	The expected default in relation to reinsurance and SPVs is dealt with in CP 44.
			Interaction with future premiums CP. The account policyholder debtors should not be increased by renewals recognised under future premiums CP. These renewals should only be assessed when the payments are due and not before.	Not accepted. CEIOPS believes that the credit risk of all policyholder debtors which are recognised in the balance sheet should be captured in the SCR.
			We are concerned that the difficulty of **internal reinsurance does not seem to be addressed** anywhere in the paper. Concerns linked with this include how to rate an internal reinsurer and what the corresponding default assumptions and loss given default values may	Ratings are dealt with in CP 51.

			be in this situation.	
30.	ABI	1.3	With regard to CEIOPS' ongoing work, we would recommend that CEIOPS refer to the extensive analysis already undertaken as part of the process for Basle 2 in this area. As a starting point, it may help to inform thinking and provide an initial estimate particularly for the calibration of the parameters.	Noted. CEIOPS actively follows the work undertaken by other relevant supervisory bodies and aims to incorporate any lesson it can learn for Solvency II. However, CEIOPS also notes that the fundamentals, scope and purpose of the Basel II credit risk model significantly deviates from the counterparty default risk model. Notably, the nature of the exposures in the counterparty default risk module differs substantially from exposures in the Basel II credit risk model regarding homogeneity and well-diversification.
31.	CEA	1.3	With regard to CEIOPS' ongoing work and in particular on calibration, in the light of ensuring a level playing field between financial institutions, we would recommend that CEIOPS refer to the analysis already undertaken as part of the process for Basel 2 in this area.	See resolution of comment 30.
32.	FFSA	3.1	According to the Directive, the scope of application of the counterparty default risk module comprises credit exposures, […] including credit to insurers or reinsurers under solvency II regime. In this particular case, we believe that the credit exposure to an (re)insurer should be taken	See resolution of comment 5.

			into account only when this (re)insurer does not cover its SCR (VaR at 99.5%). On the opposite, the undertaking should not have any requirement regarding its exposure to an (re)insurer which covers its SCR.	
33.	ROAM	3.1	According to the Directive, the scope of application of the counterparty default risk module comprises credit exposures, […] including credit to insurers or reinsurers under solvency II regime. In this particular case, we believe that the credit exposure to an (re)insurer should be taken into account only when this (re)insurer does not cover its SCR (VaR at 99.5%). On the opposite, the undertaking should not have any requirement regarding its exposure to an (re)insurer which covers its SCR.	See resolution of comment 5.
			In application of the proportionality principle, we believe that all (re)insurer which have the agreement to underwrite and are supervised by a European authority (which means that it respects the SCR) should not be included in the calculation of this module.	Not accepted. CEIOPS holds the view that even reinsurance provided by supervised undertakings is not free of credit risk. The reference to the proportionality principle is unclear.
34.	AVIVA	3.1 - 3.16, 3.65 - 3.71	Some products (such as some index-linked and unit-linked products) offer policyholders guarantees provided by third parties. It would be helpful to clarify the circumstances in which these third parties would count as counterparties for the purpose of this module.	Accepted. See revised text.
35.	DIMA	3.4 & 3.5	Scope of the modules "spread risk" and "counterparty default risk" are not mutually exclusive, which will result in grey areas.	The counterparty risk of securitisations is addressed in the counterparty default risk module

			Under which module will counterparty risk for SPVs be addressed?	unless the exposure is part of the undertaking's investments. See revised text.
36.	AVIVA	3.5, 3.65	Paragraph 3.5 clarifies what types of credit exposure should be covered under the spread risk sub-module and excluded from the counterparty default risk module; however this clarification is not included in the CEIOPS advice in section 3.2 (e.g. para 3.65). This also means that the spread risk-module must be calibrated to cover migration to the default state.	Noted. The risk of a downgrade is implicitly included in the approach. See revised text.
37.	PEARL GROUP LIMITED	3.5	We welcome the definition from CEIOPS of the difference between spread risk and counterparty default risk. We agree with the recommendation.	Noted.
38.	KPMG ELLP	3.5 (general comment)	Although paragraph 3.5 makes it clear that investments are outside the scope of this sub-module, it is not clear to us where the risk of a failure of clearing houses or exchanges (relevant exchange traded instruments where there is no single identifiable counterparty) is addressed. We believe that in a 1 in 200 year scenario a failure of the exchange is a possibility that should be addressed.	Agreed. See revised text.
39.	CRO-Forum	3.5	*"The QIS4 approach could be clarified as follows: The spread risk submodule should cover the credit risk of* • *investments as defined in the Insurance Accounting Directive (91/674/EEC) except for deposits with ceding undertakings,* • *investments for the benefit of life-insurance policyholders who bear the investment risk, and* • *credit derivatives."* 'The spread risk sub-module should cover the credit risk of investments for the benefit of life-insurance policyholders who bear the investment	Agreed.

			risk' – This classification makes sense provided that the spread risk sub-module refers to the net asset value, which is unaffected by unit linked business, as opposed to the asset portion alone, given policyholders are bearing the investment risk.	
40.	ABI	3.5	The ABI welcomes the definition from CEIOPS of the difference between spread risk and counterparty default risk. The ABI strongly agrees with the recommendation.	Noted.
41.	FFSA	3.6	We don't agree with the remark made on paragraph 3.6 and the interpretation of the article 105 of the Directive. This article says clearly that the CDR shall include derivatives. We would be in favor of including credit derivatives in the CDR module instead of the spread risk.	Not agreed. Article 105 refers to derivatives as risk-mitigating arrangements. Therefore, CEIOPS thinks that the Level 1 text is open with regard to the treatment of derivatives which are not used for risk-mitigation purposes.
42.	CEA	3.6	We understand that credit default swaps fall under this paragraph. Where the unbundling of credit and counterparty default risk is burdensome, we suggest treating the credit derivative under the counterparty default risk module.	Agreed. It is unclear what is meant by "unbundling" and that it can be avoided if the credit derivative is treated completely under the counterparty default risk module.
43.	PEARL GROUP LIMITED	3.8	We broadly agree with the scope of the credit risk that is covered by counterparty default risk. However, we would recommend adding under "risk mitigating contracts" the concept of internal reinsurance arrangements as an additional example.	See resolution of comment 44.
44.	XL Capital Group	3.8	We agree with this paragraph, but would like the wording of the first bullet to be as follows:	Agreed. See revised text.

			- risk-mitigating contracts , such as **all** reinsurance arrangements **(including internal reinsurance),** securitisations and derivatives.	
45.	KPMG ELLP	3.8, 3.11-13, 3.67	We agree that certain forms of contingent liability should fall within the counterparty default risk module. The examples given are guarantees provided, letters of credit and letters of comfort. We also agree that credit insurance should not be dealt with here, but rather in the non-life underwriting risk module. Consideration should be given to whether there are any other similar items that should be picked up in this risk module. For example, paragraph 3.6 states that the counterparty risk from credit derivatives should be covered here, but this is not then mentioned in any of the subsequent paragraphs, nor is it mentioned in the CEIOOPS advice in paragraph 3.67.	According to paragraphs 3.8 (first bullet points) and 3.65 derivatives are in the scope of the counterparty default risk module.
46.	ABI	3.8	The ABI broadly agrees with the scope of the credit risk that is covered by counterparty default risk. However, we would recommend adding under "risk-mitigating contracts" the concept of internal reinsurance arrangements as an additional example.	Agreed. See revised text.
47.	CEA	3.8	We recommend making clear that under "risk mitigating contracts, such as reinsurance", the concept of internal reinsurance arrangements is added as an additional example.	Agreed. See revised text.
48.	PEARL GROUP LIMITED	3.9 - 3.16	We agree with these points and welcome the clarity provided on the availability of guarantees and letters of credit as assets and risk mitigating instruments.	Noted.
49.	ABI	3.9 - 3.16	The ABI strongly agrees with these points and welcomes the clarity provided on the availability of guarantees as assets and risk-mitigating instruments. In the case of guarantees that are offered by third parties, for example for unit-linked and index-linked products, it would	Noted. See resolution of comment 34.

			be helpful to know in which cases these third parties would be viewed as counterparties as described in this module.	
50.	IUA	3.10	We would question whether all countries that are part of the OECD or EEA should automatically be considered risk free. In particular, we note that out of the 39 states that make up these groups, there are a number of countries which might not be considered risk-free from an investment perspective. Out of this group of countries, the OECD credit export ratings consider seven jurisdictions as having a rating of 3 or 4 (with the highest rating being 0, and the lowest rating being 7). Similarly four jurisdictions are considered by S&P as having a rating of BBB+ or less, and five jurisdictions are considered by Fitch as having a rating of BBB+ or less. One jurisdiction is considered by both agencies as being less than BBB-.

Whilst we recognise that it might be desirable not to overly rely on credit ratings for credit national exposures, perhaps partly because its use could introduce issues of pro-cyclicality on national securities in the event of a downgrade, we would question whether it is appropriate for low investment grade, or non-investment grade credit exposures to be treated as risk free.

One alternative might be to treat credit exposures as risk free if the majority of credit rating agencies consider the quality of the credit exposure of the national government to be upper or prime investment grade (i.e. AAA to A-). Lower grades might therefore attract a credit charge. An analogous system could be applied using the OECD ratings. | Noted. |
| 51. | KPMG ELLP | 3.10 | We concur with the exclusion of exposures (actual or via guarantee) | Agreed. See revised text |

			from an EEA or OECD government from the counterparty risk sub-module. This is analogous to the treatment currently adopted under the existing Solvency I directive and recognises the status of these bodies. We assume the inclusion of an exemption for "exposures in the currency of the government" relates solely to a physical holding of such currency and not to bank deposits expressed in that currency, although this could be made clearer.	
52.	Institut des actuaries	3.10	Institut des actuaires agrees that credit exposures in relation to a national government of an OECD or EEA state, or an institution covered by a guarantee of the national government of an OECD or EEA state, should be exempted from an application of the module. This exemption should be granted whatever the currency is used by the government to issue its debt.	Noted. Not agreed. CEIOPS holds the view that the exemption should only relate to exposures in the currency of the state counterparty because influence on the monetary policy of the exposure's currency is a prerequisite for the risk-freeness of the exposure.
53.	Institut des actuaries	3.11	Institut des actuaires agrees that the counterparty default risk module should not cover the underwriting risk of credit insurance but that this risk should be addressed in the non-life underwriting risk like all other non life risks.	Noted.
54.	CEA	3.11	We agree with this paragraph.	Noted.
55.	FFSA	3.12	**Guarantees given**: the consultation paper introduces in paragraphs (3.12) and (3.69) the credit risk on guarantees given by the undertaking. We would like more precision on how to understand the	Not agreed. As such commitments can occur in different legal forms, a principle

			expression "*commitment which depends on the credit standing of a counterparty*". In our view, such commitments do not exist in most undertakings, except those that have activities outside insurance (eg. AIG). Further guidance is needed on this issue in order to define clearly the scope.	based definition is required.
				In some markets it is common that guarantees between insurance and reinsurance undertakings of an insurance group are provided.
			Furthermore, in respect of comment made on paragraph 3.1, FFSA believes that Off balance exposures to an (re)insurer under solvency II which covers its SCR shouldn't be charged (and in particular between entities of a same group).	See resolution of comment 5.
56.	UNESPA	3.12 & 3.69	The consultation paper introduces in paragraphs (3.12) and (3.69) the credit risk on <u>guarantees given by the undertaking</u>. We would like more precision on how to understand the expression "*commitment which depends on the credit standing of a counterparty*". In our view, such commitments do not exist in most undertakings, except those that have activities outside insurance. Further guidance is needed on this issue in order to define clearly the scope.	See resolution of comment 55.
57.	CRO-Forum	3.12	"*As described above, the counterparty default risk module should consider the credit risk of guarantees, letters of credit, letters of comfort provided by the insurance or reinsurance undertaking as well as any other commitment which is provided by the undertaking and which depends on the credit standing of a counterparty. […] their risk should be addressed in the standard formula.*" This paragraph partially addresses the topic of intra-group guarantee	Noted.

(between 2 local entities / holding and entity; and backed with a legally binding commitment). As stated in the CP 29 on 'Ancillary Own Fund', we agree that guarantee given internally should be reflected in the counterparty risk module at solo level for the entity which benefits from it (since this entity runs the risk of a bankruptcy of the guarantor, either a bank or the Group).

At solo level, any intra-group guarantee will be treated the same way as a guarantee provided by a third party financial institution (to the extent that the guarantor is of the same financial standing than such third party financial institution). And the counterparty SCR corresponds to the counterparty risk on the mark-to-market of the guarantee, from the guaranteed entity point of view. From a Group standpoint (at consolidated level), no capital requirement is needed as the internal guarantee is eliminated.

This is the same for reinsurance: at solo level, any reinsurance given by the group must have the same treatment than any reinsurance given by an external reinsurer.

Intra-group guarantee

Backed by a legally binding commitments

Entity A	Entity B
SCR: =	SCR: +
AFR: - or =	AFR: +
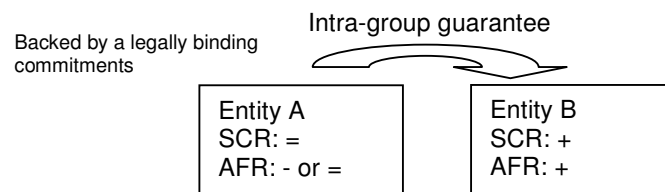
Nevertheless, further guidance is needed on the broader subject of 'guarantees given' in order to better define the scope and specifications of these guarantees.

58.	Institut des actuaries	3.12	CEIOPS introduces the credit risk of guarantees, letters of credit, letters of comfort provided by the insurance or reinsurance undertaking as well as any other commitment which is provided by the undertaking and which depends on the credit standing of a counterparty.	
			As soon as these kinds of guarantees are usually not provided by insurance or reinsurance undertakings, and as the principle of exclusive insurance or reinsurance activity applies, providing some examples can help to see the scope of the pargraph 3.12.	See resolution of comment 55.
			However, guarantees provided to ceding insurance or reinsurance undertakings are not in the scope of the counterparty default risk module as soon as they are in links with liabilities towards these ceding insurance or reinsurance undertakings. Thus, they are already covered by other modules in the SCR calculations.	Noted. See revised text on letters of credit.
			In the same way, guarantees, letters of credit, letters of comfort provided by the insurance or reinsurance undertaking in links with assets owned by the insurance or reinsurance undertaking (for example, in real estate) are not in the scope of the counterparty default risk module.	
59.	CEA	3.12 -3.16	**Guarantees -** As mentioned in 3.16, guarantee received by the undertaking which may be recognised as eligible elements of capital and which have not been activated should not fall under the scope of the counterparty default risk module (see comments to 3.6 in CP29). This should be explicitly reflected in 3.8.	Not agreed. Paragraph 3.16 is sufficient to clarify the issue.
60.	Institut des actuaries	3.13	Institut des actuaires agrees that although guarantees are liabilities and not assets, they can fall under the scope of the counterparty default risk module. The standard formula has to take into account not	Noted.

			only the probability of the counterparty but also the probability that the guarantees are activated.	
61.	Institut des actuaries	3.15	Institut des actuaires agrees that, once a guarantee provided by the undertaking is activated, it turns into a liability of the undertaking which is not under credit risk anymore and is therefore not covered by the counterparty default risk module.	Noted.
62.	Institut des actuaries	3.16	Institut des actuaires agrees that only activated guarantees have to be taken into account in the of the counterparty default risk module.	Noted.
63.	CTIP	3.17	3.1.2 Modelling approaches	
			We agree with the classification of the counterparties risk between two kind of exposure (type 1 and type 2).	Noted.
			The calculation of capital requirement for type 2 exposures based in a simple factor approach does not call remarks of our part at this stage.	Noted.
			Regarding type 1 exposures, as insurer cannot use rating in order to classify counterparties (like re-insurers), it should be important to define an alternative method which keep the simplicity of the previous one (as used in QIS4, for instance the solvency cover ratio for re-insurance).	Ratings and simplifications are dealt with in CP 51.
			Besides, we believe that the formula of calculation of the loss default should not mean to recalculate a SCR for each counterpart.	
64.	Institut des actuaries	3.17 - 3.20	Institut des actuaires agrees with the split between type 1 and type 2 exposures.	Noted.
65.	PEARL GROUP LIMITED	3.18	We agree that it may be appropriate to divide counterparty default risks into those that are undiversified and rated with those that are diversified and unrated. However, we would like more clarity on	See resolution of comment 44.

			CEIOPS' views on internal reinsurance and in which segment this would be included. Would internal reinsurance be seen as having the group rating or would it be seen as unrated?	
66.	XL Capital Group	3.18 & 3.19	We would like to see internal reinsurance addressed specifically here. We are concerned that unrated Type 1 counterparties are not considered. We would prefer internal reinsurance to unrated group captives to be classified as a Type 2 exposure. An alternative would be to classify it as a Type 1 exposure, and allow consideration of the rating of the parent entity as proxy for the captive subsidiary. However, given the large number of such counterparties in our portfolio, the task of finding the rating of a parent is resource intensive. We believe that the probability of default applied to unrated reinsurers in QIS 4 was too high, being given the same probability as entities rated CCC or lower. We have observed counterparty gradings issued by other regulators that treat unrated exposures similarly to BBB rated exposures.	See resolution of comment 44. Ratings and simplifications are dealt with in CP 51.
67.	KPMG ELLP	3.18, 3.38	We concur with the rationale for splitting the exposures into two types as identified and that a simpler approach should be adopted in relation to the type 2 exposures.	Noted.
68.	CRO-Forum	3.18 – 3.20	*"On the other hand, the use of ratings and the explicit allowance for diversification which were criticised for these particular exposures seem to be appropriate approaches for other kind of exposures like reinsurance arrangements or derivatives.* *[…]* *capital, initial funds, letters of credit as well as any other commitments received by the undertaking which have been called up but are unpaid, if the number of independent counterparties exceeds a certain*	

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			threshold."	
			Regarding the 2 types of exposure, it is very impractical to classify "deposits with ceding institutions" as a type 1 exposure if the number of independent counterparties does not exceed a certain threshold, and as a type 2 exposure, if it does. Same for *"capital, initial funds, letters of credit as well as any other commitments received by the undertaking which have been called up but are unpaid"*.	Not agreed. The split treatment of these exposures is a concession to practicability. The feedback of QIS4 participants indicates that a practical solution for exposures with a high number of counterparties is necessary.
			This leads to unexplainable diversification effects, since on entity level those exposures might be treated as type 1 exposures whereas for the Group aggregation they had to be treated as type 2 exposures.	
			That is why the CRO-Forum believes that it would increase consistency across exposures and transparency of the standard formula to remove the split between type 1 exposures and type 2 exposures.	
			In addition, we propose to open the standard formula to company internal ratings for unrated exposure.	Not agreed. CEIOPS holds the view that the use of internal ratings is not in the scope of the standard formula.
69.	ABI	3.18	We agree that it may be appropriate to divide counterparty default risks into those that are undiversified and rated with those that are diversified and unrated. However, we would like more clarity on CEIOPS' views on internal reinsurance and in which segment this would be included. Would internal reinsurance be seen as having the group rating or would it be seen as unrated? In the absence of a specific rating of the instrument, we would assume that internal reinsurance would normally be seen as having the benefit of the group rating.	See resolution of comment 44.
70.	FFSA	3.19 & 3.20	a) **Scope of type 1 and type 2 counterparties**: we would like to draw your attention on the limits of the frontier proposed	Not agreed. If the exposures in

			between type 1 and type 2 exposures, especially concerning exposures that exist in the two types, such as deposits or guarantees, where the criteria selection would be a certain threshold. The affectation could be a little difficult, arbitrary, or even need to change over time (for instance, this could lead to a different treatment in a group where at a solo level, a deposit could be classified as a type 1 exposure if underneath the threshold and as a type 2 exposure at the group level if the sum of the solo exposures drives to exceed the threshold). We would recommend classifying such types of exposures in type 2. Another advantage of this would be to make the calculation of SCR on type 1 exposures simpler and more accurate.	question are large (and therefore not numerous), the simple approach to type 2 exposures may not be sufficient risk sensitive.
			Furthermore, we would be in favor of classifying "reinsurance exposures on large risks" in the type 2 exposures. Indeed, these risks are highly diversified and ceded to a large number of reinsurers.	Not agreed. We understand that undertakings are free to reinsure large risks with a low number of counterparties.
			b) **Advance payment**: Is a loan (advance) given to a policyholder included in the scope of exposures? We would be in favor of **no requirement** for these immaterial credits.	Not agreed. According to paragraph 3.19, policyholder debtors are type 2 exposures. If the exposures are immaterial so will be the capital requirement.
			c) **Mortgage Loans**: the consultation paper does not deal with mortgage loans. Because of the difficulty to determine correctly the loss given default and especially the collateral corresponding to theses assets, **we would be in favor not to include theses assets in the base of exposures** on which a counterparty default risk is calculated. On the other hand, the	Agreed. Mortgages loans are part of the investments and therefore subject to the credit spread sub-module.

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			credit risk of these assets should be calculated in the market risk module. Anyway, further advices are necessary. d) **Deposits**: Double counting with spread risk on deposits should be avoided.	Noted. According to section 3.1.1, there is no overlap in the scopes of the counterparty default risk module and the spread risk sub-module.
71.	IUA	3.19	We are concerned that unrated Type 1 counterparties are not considered in this context. There may be reinsurance or retrocession transactions with entities in a corporate group, who are not rated, such as for example, some Special Purpose Vehicles. As suggested in CEIOPS CP36, such vehicles need to be fully funded. We would therefore tender that unrated entities should not always equal a CCC rating, as it did under QIS 4.	Ratings and simplifications are dealt with in CP 51.
			We would also comment that whilst it may be true that some of the smaller reinsurance programmes, and facultative reinsurance may not be particularly diversified, larger risks, and especially treaty reinsurance will most often be written on a subscription basis, and therefore will be more diversified. Similarly, some companies will have Binding Authority Agreements with intermediaries (where the intermediary ("the binder") writes business within a certain remit on behalf of the (re)insurer), which might form a non-negligible amount of business falling into Type 2 which is less diversified. Additionally, some brokers, Type 2 may also be rated counterparties.	Noted.
			We also feel that further guidance facilitating the Type 1/Type 2 distinction will be important.	
72.	DIMA	3.19 & 3.20	It seems that the aim is to distinguish between what are deemed to be major (Type 1) and minor (Type 2) exposures based on certain criteria.	Not agreed. The distinction between type 1 and type 2

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			Differentiation between Type 1 and Type 2 will be problematic if implemented based on current criteria such as credit rating and threshold number of independent parties. For example, not all insurance companies (e.g. mutuals) are rated and therefore may not fit in either type. There is significant risk that some large exposures will not be adequately captured.	exposures is defined in paragraph 3.20. Paragraph 3.19 only provides the motivation for the distinction defined.
			As stated above, no distinction is made between direct insurance and reinsurance although nature of counterparty exposures can be quite different.	
73.	UNESPA	3.19, 3.20, 3.72 & 3.73	We would like to draw your attention on the limits of the frontier proposed between type 1 and type 2 exposures, especially concerning exposures that exist in the two types, such as deposits or guarantees, where the criteria selection would be a certain threshold. The affectation could be a little difficult, arbitrary, or even need to change over time (for instance, this could lead to a different treatment in a group where at a solo level, a deposit could be classified as a type 1 exposure if underneath the threshold and as a type 2 exposure at the group level if the sum of the solo exposures drives to exceed the threshold). We would recommend classifying such types of exposures in type 2. Another advantage of this would be to make the calculation of SCR on type 1 exposures simpler and more accurate.	See resolution of comment 68.
			On the other hand, double counting with spread risk on deposits should be avoided.	Agreed. According to section 3.1.1, there is no overlap in the scopes of the counterparty default risk module and the spread risk sub-module.

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74.	CEA	3.19	**Treatment of unrated counterparties** - The CP does not appear to contemplate the possibility of reinsurance arrangements with unrated counterparties, for example arrangements with internal reinsurance entities in other parts of the same group. In QIS4 unrated entities were wrongly given a "CCC" rating which lead to excessive capital requirements for unrated subsidiaries. We urge CEIOPS to consider alternatives for the unrated counterparties. For unrated entities within a group, including internal reinsurers, we would expect the rating to be derived from the parent company.	Ratings are dealt with in CP 51.
75.	XL Capital Group	3.20	In a reinsurance context it is not uncommon for cedants to retain all or a portion of the reinsurance premium over a specified period. This triggers a counterparty risk. The guidance would suggest such a counterparty risk is classified as a Type 2 exposure, but usually there will be an S&P rating available for the ceding entity which could be more appropriate. We suggest that Funds Withheld be treated as Type 1 where a rating of the counterparty exists.	Not agreed. Deposits with ceding institutions are type 2 exposures if their number exceeds a certain threshold according to paragraph 3.20. This is a concession to practicability. Not all cedants may have an S&P rating.
76.	CEA	3.20	**The frontier between type 1 and type 2 exposures needs checking**. The threshold for deposits and guarantees could be difficult to find, arbitrary, or even needing to change over time. We would recommend checking the issue and classifying such types of exposures in type 2 if the analysis gives sufficient background to this solution. Another advantage would be making the calculation of SCR on type 1 exposures simpler and potentially more accurate. We would ask for clarification whether "reinsurance exposures on large risks" can be included under type 2 exposures since such risks are highly diversified and ceded with a large number of reinsurers, though we see the difficulties in separating such exposures and we also	See CP 51 for the calibration of the thresholds. Not agreed. We understand that undertakings are free to reinsure large risks with a low number of

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			acknowledge that the underlying shock assumed by ter Berg model would impact all types of exposures.	counterparties.
			Type 2 exposures may be with rated entities (eg brokers, banks acting as intermediaries for bank-insurers). It is not clear how the proposals include an allowance for such cases.	According to paragraphs 3.39 and 3.40, the rating is not taken into account.
77.	DIMA	3.21	While the deficiencies of the Vasicek-Herfindahl approach proposed in QIS4 justify CEIOPS presenting a new approach to determining the risk factors for Type 1 exposures, it is not clear that the new proposal is without deficiencies. In the absence of information on the calibration of • the parameters a and τ (shape parameters) of the loss distribution • the quantile factor q applied to the standard deviation of the loss distribution in the calculation of the capital requirement for counterparty default risk for Type 1 exposures, it is difficult to assess the impact of the proposed calculation. The approach for all Type 1 counterparties is only practical for counterparties that have a credible public credit rating and would be impractical to apply to unrated smaller counterparties.	Calibration and ratings are dealt with in CP 51.
78.	CRO-Forum	3.21	*"In the counterparty default risk calculations of QIS4 a Vasicek-Herfindahl approach was used to determine the risk factors. The default loss distribution was assumed to follow a Vasicek distribution and the diversification between the counterparties was measured by means of the Herfindahl index (cf. TS.X.A of the QIS4 Technical Specifications)."*	Noted.

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			The CRO-Forum appreciates that as a consequence of the shortcomings of the Vasicek-Herfindahl approach the counterparty default risk model will be revised. The CRO-Forum believes the new model is appropriate to cover the characteristics of counterparty default risk.	
79.	Institut des actuaries	3.21 - 3.37	The model used seems too complex for a standard formula in links with the covered risk.	Noted.
80.	ABI	3.22	The ABI strongly agrees with this point.	Noted.
81.	FFSA	3.27	We appreciate the fact that the discussion has been opened on methods to calculate the default probability. The paper gives the example of the assignment by rating agencies, but we would be in favor of letting the undertaking free to decide its frame of reference in order to design the default probability.	Not agreed. CEIOPS holds the view that the use of internal ratings is not in the scope of the standard formula.
82.	DIMA	3.27	It is not clear that considering the specific default probability as a monotone increasing function of a stress variable (and then calculating the mean of the probability weighted average over the possible values of the stress variable) corresponds to the through-the-cycle rating assigned by rating agencies.	The probability of default that will be assigned to the rating is usually based on a long time series of annual default rates of the rating class.
83.	CEA	3.29, 3.64, 3.77, Annexes A & B	**Details of the calibration are requested as soon as possible** - The absence of calibration (or description of the methodology to be used to calibrate the formula) makes it difficult to comment on appropriateness of capital requirement. Further, comments with regards to when this will be addressed (level 2 or level 3) would be welcome.	Calibration is dealt with in CP 51.
			Initial views on the proposed model - The ter Berg model structure appears to be a useful structure with which to construct a formula for capital requirements for counterparty default risk (however note the	Noted.

general comment above).

In our view, the proposed model has the following favourable characteristics:

- The model results in a capital charge which is a decreasing function of the number of counterparties, avoiding the unusual effects of the QIS4 approach for some ratings categories

- The model is based on a portfolio approach and a covariance structure between default indices

- The model results in expected defaults for each rating category equal to the input default probabilities

In general the updated approach for calculating the capital requirement for type 1 exposures is found to be a step in the right direction, given the partly inconsistent results from QIS 4 especially relating to correlation and diversification effects (3.23 and 3.24). However, in the new approach the calculation makes use of two important (for the result) but in practice unobservable parameters. At this point in time it is not very clear how to calibrate these which opens up for both substantial model and parameter risk. Specific comments which relate to the calibration of the model include:

- The assumption that correlation between probability of defaults for type I exposures is driven by relative sensitivities across exposures to a single shock random variable is open to challenge – particularly between reinsurance and derivative counterparties, but also between predominantly life and non-life reinsurers. No

See 3.26. Examples of such shocks are financial market crisis and catastrophes with an effect on a higher number of

			justification is provided for the beta-like distribution of this shock random variable.	counterparties like pandemic or severe natural catastrophe. The modelling of differences in the dependence structure would add an undue complexity to the approach.
			● The example in Annex B assumes the same values of the alpha and tau parameters for all ratings categories – it is not clear whether this is a reasonable assumption.	For a standard formula approach the differentiation of alpha and tau in relation to rating classes appears to be too complex (cf. for example comments 13 and 15).
			● There is no comment in the CP on the possible procyclical effects of downgrades of type I exposure counterparts. Capital requirements would increase if the counterparties are downgraded. This may incentivise the recapture (and rebroking) of the reinsurance treaties with the affected counterparties which may in turn further worsen the position of those reinsurers. Also if the downgrade of derivative counterparties is the result of large financial shocks (as currently) the increase in capital requirements for counterparty default risk may add further pressure to already weakened capital positions of insurers - this may increase the pressure to dispose of risky assets. This could be allowed for in the calibration of the model, for example via the distribution of the shock variable, but it is not currently clear how this would be achieved.	See resolution of comment 11.

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84.	PEARL GROUP LIMITED	3.30	We do not agree that the LGD figures should be constant when they should be stochastic. We can see that CEIOPS is looking for a solution that will be credible and simple to apply in practice, but more details of this model need to be provided before we can agree that this model is appropriate. Furthermore, the assumption that the distribution for the LGDs is a normal distribution is a large assumption, although it is easier to implement.	The use of a stressed LGD figure is a concession to practicability. Moreover, the distribution of the LGD is not known.
85.	CRO-Forum	3.30	*"Given probabilities of default and losses-given-default (LGD) of the counterparties in the portfolio of type 1 exposures, the model provides an estimate V of the variance of the portfolio's loss distribution. This estimate can be used to calculate the capital requirement for type 1 exposures as follows:"[refer to original for formula]* The new formula for type 1 exposure just like the one tested during QIS4 requires the calculation of the loss given default for the individual counterparties. Although the CRO Forum believes that over time, as Solvency II is imbedded into insurance practice, smaller companies should be able to measure individual counterparty exposure. This will not likely be the case for some time. In addition, the exposures may not be material enough to warrant the additional evaluation and measurement. We treat this aspect in more detail in our comment to Para 3.53.	Simplifications are dealt with in CP 51.
86.	ABI	3.30	We do not agree that the LGD figures should be constant when they should be stochastic. We can see that CEIOPS is looking for a solution that will be credible and simple to apply in practice, but more details of this model need to be provided before we can agree that this model is appropriate. Furthermore, the assumption that the distribution for the LGDs is a normal distribution is a large assumption, although it is easier to implement.	The use of a stressed LGD figure is a concession to practicability. Moreover, the distribution of the LGD is not known.

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87.	CEA	3.30, 3.31	More details of this model need to be provided before we can state that this model is fully appropriate. The assumptions for the various distributions would need checking in order to ensure stability of results.	Noted.
88.	ABI	3.31	We would suggest that assuming that the loss distribution is a lognormal distribution is a large assumption, although it is easier to implement. We would suggest further investigation of possible probability functions.	Cf. CP 51.
89.	CEA	3.34, 3.61, 3.62	**The term "rating" must be clearly defined** – The CEA views favourably a potential move away from ratings provided by credit ratings agencies. The CEA suggests using ratings bands based on SCR coverage ratios (for counterparties under Solvency 2). As a consequence, undertakings currently unrated by rating agencies would not have CCC status anymore.	Ratings are dealt with in CP 51.
90.	CEA	3.35, 3.89	The formula should be corrected with j replacing i in the last term, to conform to the correct formula stated under A.14	Agreed. See changed formula.
91.	IUA	3.1.4	Where an intermediary is EU regulated, and the Member State (or indeed the intermediary does so through its own volition) holds strictly segregated client accounts as per Article 4.4(c) of the Insurance Mediation Directive, then we would question whether it is necessary for an (re)insurer to have any Type 2 exposures due for that intermediary. The very purpose of strictly segregated client accounts is that those accounts will not be used to reimburse other creditors in the event of bankruptcy. We would tender, that where it is evidenced that segregated accounts are held, a counterparty default charge would be excessively prudent. An analogous argument can be applied to circumstances where a guarantee fund has been set up.	Not agreed. The segregated clients accounts serve the protection of the policyholder, but may not mitigate the counterparty default risk of the (re)insurance undertaking.

92.	CRO-Forum	3.38	*"[…] type 2 exposures often relate to unrated counterparties and an undertaking's portfolio usually consists of a larger number of such exposures. Moreover, in most cases the default risk originating from these exposures is very small compared to the overall risks. Therefore, rather than attempting to address the individual risk characteristics of each exposure and their interdependencies a quantification of the level of the portfolio of type 2 exposures appears to be suitable. This can be done in a simple factor-based approach."* The CRO-Forum believes type 2 exposure should be treated like type 1 exposure. The introduction of a different modelling framework does not increase consistency across different exposures. The distinction between the two exposure types is fuzzy and somewhat arbitrary.	See resolution of comment 68. Not agreed. We cannot detect fuzziness in the distinction.
93.	Institut des actuaries	3.38 - 3.42	The parameters x and y should be entity specific in links with the kind of type 2 counterparties of the entity. An upper and lower limit to the parameters could be set. Each undertaking has to prove the right level of the parameters. Using unique parameters for the European market doesn't seem correct.	Not agreed. CEIOPS holds the view that the use of internal ratings is not in the scope of the standard formula.
94.	PEARL GROUP LIMITED	3.39	It is difficult to see what the impact of this method would be without more details on the likely values of the parameters.	Calibration is dealt with in CP 51.
95.	ABI	3.39	It is difficult to see what the impact of this method would be without more details on the likely values of the parameters.	Calibration is dealt with in CP 51.
96.	CEA	3.39	**A more granular approach to the variables x and y could be helpful** while avoiding the risk of the formula becoming unduly complex. In particular, it should be possible these variable to be entity specific. This would provide an incentive for diversification or	Noted.

			management of counterparty default risk for Type 2 exposures. The specific treatment of amounts due from intermediaries for more than T months should be reviewed and eliminated in case the granularity/complexity threshold is tilted too much towards complexity. At this moment in the consultation process, it is difficult to see what the impact of this method would be without more details on the likely values of the parameters.	Calibration is dealt with in CP 51.
97.	PEARL GROUP LIMITED	3.40	If x does not depend on the probability of default, this would assume that this exposure is always covered at 100%. Any reduction in the amount likely to be lost is only considered to be as a result of diversification effects. We would recommend that a careful analysis is done of the possible factor for diversification to avoid under-estimation or over-estimation.	Calibration is dealt with in CP 51.
98.	ABI	3.40	If x does not depend on the probability of default, this would assume that this exposure is always covered at 100%. Any reduction in the amount likely to be lost is only considered to be as a result of diversification effects. We would recommend that a careful analysis be done of the possible factor for diversification to avoid under-estimation or over-estimation.	Calibration is dealt with in CP 51.
99.	IUA	3.41	Given the above, this paragraph notes that the value of exposures might be reduces by the value of the collateral for the exposure, (as well as the net liabilities with a same legal entity). We would also suggest that it should permitted that where monies from intermediaries are identified as being held in strictly segregated accounts (or covered by a guarantee fund), such exposures would not be included in the sum of values of type 2 exposures, E.	Not agreed. See resolution of comment 91.

100.	Institut des actuaries	3.41	Concerning type 2 exposures, the asset value should be netted with the liability value for the same counterparty if the asset and the liability are linked. Therefore, there will be often no counterparty risk for French "avances" (loan to an insured person in links with its mathematical reserve) or in France for premiums up to the reserves for the same insured people, in links with the usual default rate of the undertaking.	Noted.
101.	PEARL GROUP LIMITED	3.42	We think that this may be better phrased as "…receivables from intermediaries which are due for a longer period of time have a much higher probability to be subject to default. Therefore, …" As it is currently, it is unclear as to whether the longer period of time results in a greater or lesser likelihood of being paid.	Agreed. See revised text.
102.	International Group of P&I Clubs	3.42	*Calculation of LGD for type 2 exposures* CP 28 sets out a proposed method to determine the capital required against 'type 2' exposures, including receivables from policyholders. This category would include outstanding calls from the members of a P&I Club. The approach proposed in the CP uses a risk factor, but the likely value of this risk factor is not clear from the CP. Para 3.42 of CP 28 alludes to the view that type 2 exposures due for a longer period would attract a higher risk charge. Members of the IG have access to substantial data on call collection and historical default rates and this data could be used to develop a risk factor appropriate to the P&I Clubs' outstanding calls. A P&I-specific factor would avoid the possibility of risk capital for calls that	Calibration is dealt with in CP 51. Not agreed. The risk factor y applies only to intermediaries but not to other type 2 exposures. Not agreed. A partial internal model could be used to reflect these particularities of P&I clubs.

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			have already been made being overstated, especially as these calls are often not due for collection until some time after actually being called.	
103.	International Group of P&I Clubs	3.42	*Supervisory approval for ancillary own fund items* CP 29: *Own funds – Supervisory approval of ancillary own funds* contains a three stage process that supervisors will follow in order to grant approval for ancillary own fund items, although the precise method by which the assessment will be made is not clear. The IG suggests that in the case of unbudgeted supplementary calls from P&I Clubs, a similar approach should be taken to the assessment of credit risk against outstanding member calls, using the P&I specific risk factor described above.	Noted.
104.	ABI	3.42	We think that this may be better phrased as "…receivables from intermediaries which are due for a longer period of time have a much higher probability to be subject to default. Therefore, …" As it is currently, it is unclear as to whether the longer period of time results in a greater or lesser likelihood of being paid.	Agreed. See revised text.
105.	CEA	3.42	It's not clear if "*lower*" rather than "*higher*" was intended in the paragraph.	Agreed. See revised text.
106.	KPMG ELLP	3.1.5 & 6 (general comment)	While paragraph 3.46 recognises that there could be a partial recovery from the counterparty and takes this into the calculation, there may be other forms of recovery that are not considered in either paragraphs 3.46 or 3.55. An example of such a form of recovery could be any compensation that may be available from industry wide compensation schemes. Although these are often aimed at protection of the consumer, in some cases there may be protection afforded to retail	Not agreed. These compensation schemes usually only protect the policyholder, but not other creditors.

			firms.	
			Where this is the case, it would seem appropriate for some recognition of the likely recoverable amount to be included in the recovery rate calculation.	
107.	AVIVA	3.43 - 3.53	Section 3.1.5 defines LGD for SPVs in terms of the risk-mitigating effect in the underwriting risk module. Whilst presumably SPV in this context refers to SPVs as defined in the Directive and so involve a transfer of insurance risk, perhaps there could be SPVs which provide risk-mitigation against the market risk module in which case the formula for 'derivatives' would be more appropriate – it should be the nature of the risk-mitigation which determines the LGD formula not the legal form of the instrument. It is also not clear whether the value of collateral in the formula needs to be stressed.	Agreed. See revised text.
108.	ABI	3.43	The ABI strongly agrees with this point.	Noted.
109.	CEA	3.43 - 3.52	References to the capital requirements for underwriting risks and market risk respectively possibly indicate that diversification effects against other risks may be excluded from the calculation of loss given default in the future. Such diversification would need to be excluded if the counterparty default risk module is to produce a 99.5% VaR measure. For example, if we assume that a currency exposure is hedged by a forward FX contract. Take two otherwise identical companies, where one has a large equity exposure and the other hasn't. The market risk calculation of the first company is dominated by the equity exposure and the forward FX contract has only a relatively small effect on the resulting market risk. For the other company, the forward FX contract may well have a much larger effect on the resulting market risk, if the	To be discussed (see former CP51).

			currency exposure that is hedged is of prime importance to the market risk of the company. The resulting LGD will thus potentially differ substantially between those two companies, although they have the same forward FX contract and thus the same counterparty default risk. Hence, the way LGD is specified – by reference to how much market risk is reduced by the FX contract – does not meet the requirement in article 104.4 that each module should be specified to produce a VaR 99,5 % measure.	
110.	CEA	3.45	In connection to the existing consultation paper on financial mitigation techniques (CP 31), the CEA argues that such techniques should be taken into account in the calculation of the risk capital under the counterparty default risk. As a consequence, if there is a policy of the undertaking to ensure immediate replacement of the lost cover due to default of counterparty, the RM should be replaced by the premium paid for such a replacement.	Not agreed. The term RM reflects the risk that the exposure may be higher than the current recoverables (or the current market value of the derivative) when the counterparty defaults. Therefore, a premium paid for a replacement could be added to LGD to reflect the undertaking's policy. However, it appears difficult to estimate the value of the premium seem in advance.
111.	PEARL GROUP LIMITED	3.46	We would suggest that the sentence on recovery rates be rephrased as "… the LGD is reduced by a factor RR where RR denotes the recovery rate …". The factor (1 – RR) is one of the *positive* components of LGD and so *adds* to the LGD and does not reduce it.	Agreed. See revised text.
112.	KPMG ELLP	3.46, 3.47, 3.49, 3.50, 3.77 & 3.80	We agree that any potential recovery from a counterparty should be taken into account in the determination of the counterparty default risk-module, and as stated in the general comments above also believe this should be extended to consider any potential recoveries from other	Noted.

			sources.	
			However, we do not believe that the risk mitigating effect element of the formulae in paragraphs 3.47, 3.50, 3.77 and 3.80 should be reduced by the recovery rate. The risk mitigating effect is defined in paragraph 3.49 as the difference between the capital requirement for underwriting the risk given that any reinsurance is not taken into effect and the capital required for underwriting risk with the reinsurance in place. In effect this is the additional capital that would be required if the reinsurance was no longer in place. If the reinsurer was to fail, then the entity will need to put up this additional capital in full regardless of the rate of recovery.	Not agreed. The term RM reflects the risk that the exposure may be higher than the current recoverables (or the current market value of the derivative) when the counterparty defaults. Therefore, the recovery rate should also reduce RM.
			This calculation does not give any consideration of the time required to receive the recovery. In practice there is likely to be a protracted period from the event of default to the eventual settlement of the counterparty's creditors, so we believe a time discounting element should be included within the calculation.	Partly agreed. The possible time lag relating to the recovery of the counterparty should be reflected in the calibration of the recovery rate. See revised text (see former CP51).
113.	ABI	3.46	We would suggest that the sentence on recovery rates be rephrased as "… the LGD is reduced by a factor RR where RR denotes the recovery rate …". The factor (1 – RR) is one of the *positive* components of LGD and so *adds* to the LGD and does not reduce it.	See resolution of comment 111.
114.	CEA	3.46	We question whether the sentence on recovery rates should be better rephrased as *"… the LGD is reduced by a factor RR where RR denotes the recovery rate …".*	See resolution of comment 111.
115.	CEA	3.47, 3.50	The Recovery rate on default is difficult to estimate due to the lack of historical data, the variability of the historical recovery rates from one default to the next, and the need to estimate recovery rates in a	Noted.

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			stressed scenario.	
			The recovery rate and default rate are potentially dependent assumptions. (i.e. the same counterparty can be calculated with a lower probability of default and lower recovery rate or a higher probability of default and higher recovery rate)	Not agreed. As the recovery rate is difficult to estimate, a differentiation of the rate according to default probability appears to be difficult.
			The recovery rate is currently defined to apply to the whole counterparty exposure rather than to the outstanding exposure net of collateralisation. Depending on how the recovery rate is to be defined and calibrated it may be more appropriate to express the LGD as, for example: $LGD_i = \max((1 - RR_{re})(Recoverables_i + RM_{re,I} - Collateral_i) ; 0)$	Agreed. See revised text.
116.	CEA	3.48	Further guidance is requested on the netting off of recoverables against liabilities, to ensure that unreasonably adverse effects are avoided. Consideration will need to be given to a range of common practices in a number of members states with respect to loans and prepayments, including: • Ensuring that policy loans are offset against policy liabilities. • Considering prepayments, such as the practice of insurers reimbursing hospitals for claims which will arise in the coming year. These claims will be made on behalf of the policyholder rather than the hospital. It makes a significant difference whether these pre-payments are considered as IBNR claims or as receivable for Solvency II purposes, and in the latter case whether they can be offset against liabilities. For IFRS purpose	Noted. Se revised text.

			such claims are netted off against technical provisions.	
117.	PEARL GROUP LIMITED	3.49	We would prefer more clarity on this paragraph. Is the first bullet point the area where one assesses the impact of including the reinsurance arrangements or SPV securitization? We have assumed that the average is between full allowance of reinsurance arrangements and no allowance, so that an intermediate value may be used that gives only a partial allowance for reinsurance arrangements or SPV securitization.	The term RM is further defined in CP 51.
118.	ABI	3.49	We would prefer more clarity on this paragraph. Is the first bullet point the area where one assesses the impact of including the reinsurance arrangements or SPV securitization? We have assumed that the average is between full allowance of reinsurance arrangements and no allowance, so that an intermediate value may be used that gives only a partial allowance for reinsurance arrangements or SPV securitization.	The term RM is further defined in CP 51.
119.	PEARL GROUP LIMITED	3.51	We would prefer more clarity as to whether the lack of amendments to the market risk implicitly includes an allowance for risk mitigation. This is a similar point to our comments to Para 3.49.	The term RM is further defined in CP 51.
120.	ABI	3.51	We would prefer more clarity as to whether the lack of amendments to the market risk implicitly includes an allowance for risk mitigation. This is a similar point to our comments to Para 3.49.	The term RM is further defined in CP 51.
121.	PEARL GROUP LIMITED	3.52	We would welcome simplifications and would welcome the opportunity to provide feedback on CEIOPS proposals when available.	Simplifications are dealt with in CP 51.
122.	ABI	3.52	The ABI would welcome simplifications and would welcome the opportunity to provide feedback on CEIOPS' proposals when available.	Simplifications are dealt with in CP 51.
123.	CEA	3.52 & 3.53	**The CEA asks for further simplification of the methods in the**	Simplifications are dealt with in

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			calculation of loss given default, as otherwise the calculation could be very onerous (particularly where there are many Type I counterparties).	CP 51.
124.	PEARL GROUP LIMITED	3.53	We would welcome the opportunity to comment on the calculation put forward by CEIOPS when it is drafted.	Simplifications are dealt with in CP 51.
125.	DIMA	3.53	LGD: advice on calculation to be determined; is there a timeline for this?	Simplifications are dealt with in CP 51.
126.	CRO-Forum	3.53	*"CEIOPS acknowledges that the QIS4 approach to the calculation of the risk mitigating effect requires further simplification. Advice on the concrete calculation of the risk mitigation effect will be given at a later stage."* CEIOPS recognizes that the calculation of the risk mitigation effect needs simplification. The CRO-Forum supports this view. In particular, the calculation may be laborious for reinsurance arrangements even if they are market standard. The CRO-Forum proposes to calculate the total risk mitigation effect $SCR_{gross} - SCR_{net}$ of all reinsurance arrangements and derivatives, respectively, and to break it down to the individual reinsurance arrangements and derivatives by a simple volume measure such as the recoverables and the market value. As part of the Pillar II process, (re)insurance undertakings should be able to demonstrate their supervisor the reasonableness of this approach.	Simplifications are dealt with in CP 51.
127.	ABI	3.53	The ABI would welcome the opportunity to comment on the calculation put forward by CEIOPS when it is drafted.	Simplifications are dealt with in CP 51.
128.	PEARL GROUP LIMITED	3.54	We believe that loss given default rates are stochastic, and so even over the time horizon of the SCR, the LGD is likely to change. We suggest that this is an area that requires more discussion.	See resolution of comment 84.

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129.	ABI	3.54	The ABI believes that loss given default rates are stochastic, and so even over the time horizon of the SCR, the LGD is likely to change. We suggest that this is an area that requires more discussion.	See resolution of comment 86.
130.	CEA	3.54	We welcome the opportunity to comment on the calculation put forward by CEIOPS later.	Noted.
131.	IUA	3.58	Notwithstanding our General Comment 3 we welcome the fact Type 1 exposures account for diversification benefits between independent counterparties.	Noted.
132.	PEARL GROUP LIMITED	3.58	We agree with this recommendation.	Noted.
133.	KPMG ELLP	3.58, 59	Whilst we agree that exposure to a counterparty should include its connected parties, we are concerned about the reference in paragraph 3.59 (and in particular the footnote thereto) which would mean that all participations and entities connected by a relationship (as opposed to shares) are included. There are two practical aspects here – firstly, it may not be possible for a (re)insurer to identify all such entities for its counterparties and secondly, there could be more than one such relationship. For example, a participation is defined in this sense by reference to control or a 20%+ holding. It is unlikely to always be possible for a (re)insurer to be able to identify all entities that are a participation solely by reference to control. Similarly, it is possible for one entity to be owned by five companies. In such a case, it is unclear which of these entities a (re)insurer should consider it connected with for the purposes of this sub-module.	Noted.
134.	ABI	3.58	The ABI agrees with this recommendation.	Noted.

135.	CEA	3.58	We agree with this recommendation.	Noted.
136.	CRO-Forum	3.59	*"[…] the different legal entities of the group or financial conglomerate should be treated as one counterparty in the module calculations and no diversification effects between the entities are taken into account in the capital requirement. Cross-sectoral developments on the treatment of intra-group relations may be taken into account for further developing the notion of dependency."* Stronger dependencies between different counterparties belonging to the same financial conglomerate should be taken into account. However, the assumption of full dependence of such counterparties may not be adequate. This assumption leads to the treatment of all legal entities of one group as a single counterparty. Although this assumption may be correct in many situations, there are situations where this assumption would not be accurate. We propose leaving it to the (re)insurance undertaking to justify as part of the Pillar II process, the approach they have taken to the aggregation of counterparty risks for members of the same parent company.	Not agreed. CEIOPS hols the view that the dependence assumption should be specified in the Implementing measures.
137.	CEA	3.59	We suggest different legal entities of a group should be treated the same.	Noted.
138.	Deloitte Touche Tohmatsu	3.61	The paper includes mention of a separate rating class for counterparties with unknown credit standing. We believe that greater supervisory flexibility would be appropriate here, as there are a number of reasons why a firm could be of strong credit standing but fail to have a published rating, e.g. a firm within a large group. In such circumstances, when it can be demonstrated that the unrated counterparty is super-equivalent to a different rating category, then	Ratings are dealt with in CP 51.

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			the counterparty recovery rate should be based upon this rating category, rather than using the unknown rating recovery rate. We recommend that the Level 2 wording provides for Level 3 guidance to be prepared setting out the circumstances when supervisors might agree to firms taking such an approach.	
139.	Lloyd's	3.61	There is mention of a possible class of "unknown credit standing". We believe this is an area where further refinement should be made as there are many providers of risk mitigating products that may not have a credit rating but are financially sound. This may occur for a number of reasons. An example of which would be a provider being a relatively small (unrated) component of a larger (rated) group. We do not believe the correct treatment is to treat in a single "unknown rating" group as this will certainly be penal. An alternative would be to include an option to use an "equivalence rating" for an entity if it can be proved this would be appropriate. In the example of an unrated component of a larger group, the group rating may be more appropriate. Paragraph 3.86 could be interpreted to mean this and clarification regarding the treatment of differing ratings within a group would help clarify the position.	Ratings are dealt with in CP 51.
140.	PEARL GROUP LIMITED	3.62	We would like to recommend that CEIOPS engages early with companies in any discussion of the details of rating classes.	Ratings are dealt with in CP 51.
141.	DIMA	3.62	CEIOPS will provide further advice to take best account of ongoing developments in the regulation of rating agencies" the current CEIOPS advice does not cover this assignment (proposed date?)	Ratings are dealt with in CP 51.
142.	ABI	3.62	The ABI would like to recommend that in any discussion of the details of rating classes, CEIOPS engages early on in discussion with the	Ratings are dealt with in CP 51.

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			industry on the best methods of achieving this outcome. This was a very important issue for QIS4 for firms and the industry would like the opportunity to discuss their concerns in more detail on this significant issue.	
143.	FFSA	3.64	**Entity specific parameters**: for type 2 exposures calculation, we would be in favor of offering the possibility for undertakings to use for their entity specific parameters as in the QIS4.	Not agreed. CEIOPS believes that internal rating approaches are not within the scope of the standard formula. QIS4 did not include such an approach.
144.	IUA	3.64	The calibration of the parameters will have an important impact upon the calculation of the capital requirement. We feel that the proposal for this module can only be properly judged once these parameters are known (and tested), and would therefore urge the calibration to be provided as soon as possible.	Calibration is dealt with in CP 51.
145.	PEARL GROUP LIMITED	3.64	We would like to be involved in any discussions on the thresholds, parameters, factors, rating classes and risk factors.	Calibration is dealt with in CP 51.
146.	XL Capital Group	3.64	The recovery rates (RR) used to determine the Loss Given Default (LGD) are not specified – calibration is to be advised later. We believe that recovery rates akin to the QIS 4 level (50%) are more appropriate / realistic than the recovery rates used in QIS 3 (0%). Until recovery rates are specified it is not possible to assess the true impact of the proposal. We would encourage the calibration to be provided as soon as possible.	Calibration is dealt with in CP 51.
147.	ABI	3.64	The ABI would like to emphasize that the industry would like to be involved in any discussions on the thresholds, parameters, factors, rating classes and risk factors. We would also suggest that CEIOPS	Calibration is dealt with in CP 51.

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			may wish to use material developed in the Basle 2 discussions on counterparty default risk. Whilst CEIOPS may not agree with their final recommendations, the extensive background work done in this area may provide a good basis for further work in this area. If CEIOPS does arrive at a different conclusion, they will need to be able to explain the reasons for those differences and consider the risks of regulatory arbitrage.	
148.	Pricewaterho useCoopers LLP UK	3.64	• Additional guidance is required on calibration of the module. In particular, for type 2 exposures guidance/clarification is required on how the "risk factors" x and y are to be determined for the unrated counterparties and the time period of "T" months needs to be specified.	Calibration is dealt with in CP 51.
149.	CEA	3.64	The CEA would like to emphasize that the industry would like to be involved in any discussions on the thresholds, parameters, factors, rating classes and risk factors.	Calibration is dealt with in CP 51.
150.	Lloyd's	3.2.1	We agree with the proposed scope of the module.	Noted.
151.	PEARL GROUP LIMITED	3.65 - 3.71	We agree with the scope of the counterparty default risk module.	Noted.
152.	KPMG ELLP	3.65	Further consideration should be given to the nature of the undertaking's debtors. For example there are other sources of counterparty risks such as custodians and clearing houses. The risk is also influenced by factors such as whether the regulatory environment requires the client's assets (in this context the assets of the (re)insurer as a client of the counterparty) to be segregated for example. Where segregated assets are held, this can improve the recovery in a default situation. The nature of the legal environment, the contracts, the	See resolution of comment 38. Agreed. See revised text on segregated assets.

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			structure of the counterparty, etc all have significant impacts on the level of recovery following a default.	
153.	ABI	3.65 - 3.71	The ABI strongly agrees with the scope of the counterparty default risk module.	Noted.
154.	KPMG ELLP	3.66	We suggest that consideration be given to classifying financial reinsurance under credit risk since the primary purpose of the reinsurance is to provide financing rather than provide a risk mitigating effect.	See resolution of comment 26.
155.	FFSA	3.69	See comments to Para 3.12	See resolution of comment 55.
156.	CEA	3.69	The assessment of guarantees should be clarified including both the definition and module allocation	Partly agreed. According to paragraph 3.69 the risk of guarantees is addressed in the counterparty default risk module. Regarding the definition of guarantee see revised text.
157.	UNESPA	3.70	Other credit exposures different from national government should be exempted from an application of the module (tax credits, credit exposures in relation to international organizations to which a Member State of the European Economic Area belongs, etc.).	Not agreed. Tax credits should be exempted if they meet the requirements specified in paragraph 3.70. Membership of an EEA state does not ensure that the dept of an international organisation will be cleared.
158.	CEA	3.70	It is not clear why the exemption should only apply to exposures in the currency of the government.	See resolution of comment 52.
159.	Lloyd's	Section 3.2.2	We agree with splitting the counterparties into 2 distinct types.	Noted.

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160.	AVIVA	3.72	Separating exposures into Type 1 and Type 2 is a sensible development which we support.	Noted.
161.	AVIVA	3.72 - 3.73	For deposits with ceding institutions and capital, letters of credit etc the type 2 approach is to be used if the number of independent counterparties exceeds a threshold, otherwise type 1. It is not clear whether the type 2 formula in this case would be compared against the type 1 approach for these exposures and the lower result taken (or whether the parameter construction would ensure this is always the case). Otherwise there is some scope for inconsistent result to arise as the number of counterparties crosses the threshold.	No comparison needs to be made. The calibration of the threshold on the parameters of both approaches should ensure that the inconsistencies are not material. See CP 51.
162.	PEARL GROUP LIMITED	3.72 - 3.74	We believe that this approach is an improvement on the QIS4 method which imposed a higher capital requirement on an internal reinsurance arrangement for Pearl than a look through approach. However, we need to know more about the parameters before we can assess accurately the effects of this method. This method also does not provide a way of assessing the counterparty default risk for an internal reinsurer. We would welcome clarification from CEIOPS as to where they believe this would be reflected in the proposed method.	Calibration is dealt with in CP 51.
163.	Dutch Actuarial Society	3.72 - 3.73	3.2.2 Calculation of the capital requirement for counterparty default risk As a result of the specifics of the Dutch health insurance system, health insurers generally have substantial exposure towards hospitals in terms of receivables. These counterparts do not have credit ratings and were in QIS4 as a result of this charged with a 33 % default chance leading to very high levels of required capital not reflecting the underlying risks of the business. CP 28 suggests an enhanced framework for determining counterparty default risk by introducing two	

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			separate risk categories.	
			However, the exposure to the non-rated hospitals is generally not well diversified, potentially making one of the key assumptions behind risk category 2 not applicable (paragraph 3.20). Furthermore, hospitals are not specifically mentioned under 3.19 nor under 3.20 and it is therefore not clear under which category CEIOPS envisaged to place these counterparties. As a result of this, it is at this stage unclear to what extend this adjusted methodology will assist in mending the identified issues with respect to counterparty default risk for the Dutch health insurance industry.	All exposures under the scope of the counterparty default risk module which are not specified in paragraph 3.72 are type 2 exposures. This includes exposures to hospitals.
			We would advice CEIOPS to expand the risk type 2 category by introducing a separate factor for non-rated not well diversified exposures. Calibration of the factor could ideally be overwritten by the insurance company after local supervisory approval.	Calibration is dealt with in CP 51.
			More generally, we believe the risk type 2 category should be expanded such that different risks can be treated adequately. Rather than using a one size fits all x, we recommend using several x_i allowing for differentiation between the different groups. The particular case of the Dutch health care system with respect to the hospitals could be solved using one of the subcategories.	
164.	XL Capital Group	3.72 – 3.74	While this appears to be a preferable approach to that used in QIS 4, we would like clarification of how this should be applied to internal reinsurance, and would like the opportunity to test the approach with given parameters before concluding.	See resolution of comment 44. Calibration is dealt with in CP 51.
165.	ABI	3.72 - 3.74	The ABI believes that this approach is an improvement on the QIS4	Calibration is dealt with in CP 51.

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			method. However, we need to know more about the parameters before we can assess accurately the effects of this method. This method also does not provide a way of assessing the counterparty default risk for an internal reinsurer. We would welcome clarification from CEIOPS as to where they believe this would be reflected in the proposed method. In the case of guarantees from third parties e.g. index-linked and unit-linked products, the ABI would like guidance from CEIOPS as to the requirements for these third parties being treated as counterparties for the purpose of calculating this risk. In this area as in the other areas where a new method for calculating this risk is likely to be implemented we would recommend that a quantitative impact study be done to assess the effect of this method.	See resolution of comment 34. Agreed. The method should be tested in QIS5.
166.	AVIVA	3.74	Adding the SCR for Type 1 and Type 2 exposures (i.e. assuming 100% correlation between them) is conservative, but we think this is a sensible practical approach.	Agreed. See revised text.
167.	Lloyd's	3.74	The proposal for the two elements of counterparty default risk to be added together effectively ignores any potential diversification between these two very different types of risk. We believe the two types of counterparty would have different characteristics which would lead to some diversification. We recommend incorporating a simple correlation matrix, as in other parts of the proposed standard formula, to allow for this feature.	Agreed. See revised text.
168.	KPMG ELLP	3.74	Currently there is no diversification allowed between type 1 and type 2 counterparty risks. We believe that this may require further consideration.	Agreed. See revised text.
169.	AVIVA	3.75 - 3.89	The calculation of the capital requirement for Type 1 exposures is an improvement over QIS4. However we still believe it is	Simplifications are dealt with in CP 51.

			disproportionately complex and could be simplified further. We also suspect that the approach will be disproportionately onerous to implement in practice.	
170.	AVIVA	3.75 - 3.89	Also for the calculation of the capital requirement for Type 1, without any indication of the values of key parameters (e.g. u, v and w in para 3.89) it is not possible to benchmark the results from this approach from those used internally and to understand the impact of the proposals. We think there should be scope for there to be significant diversification benefits between Type 1 exposures to reflect risk management practice e.g. to diversify across reinsurers and diversify cash holdings across banks, but it is not clear whether this will be the case. We believe some kind of quantitative impact study is required to test proposed parameters.	Calibration is dealt with in CP 51. Agreed. The method should be tested in QIS5.
171.	PEARL GROUP LIMITED	3.75	We believe that more thought needs to be given as to the distribution behind the default rates and as to whether it is stochastic or constant.	The new approach is based on the assumption that default rates are not constant. This is in line with the default statistics of credit rating agencies.
172.	ABI	3.75	We believe that more thought needs to be given as to the distribution behind the default rates and as to whether it is stochastic or constant. We would like CEIOPS to clarify the rationale behind their statement that multiple exposures within the risk types (1 and 2) are independent.	The new approach is based on the assumption that default rates are not constant. This is in line with the default statistics of credit rating agencies.
173.	International Group of P&I Clubs	3.77	_Calculation of LGD for type 1 exposures_ The Advice given in CP28 distinguishes between 'type 1 exposures', which include exposures in respect of reinsurance arrangements, and 'type 2 exposures', which include debtors from policyholders. This	In the particular circumstances of the P&I Clubs and on the basis of this explanation, it would appear that subject to Principle 2 of CP 31 (Legal certainty, effectiveness

distinction appears to the IG to be sensible given the differing nature of these exposures.

Paragraph 3.77 of the Advice in CP 28 sets out the calculation of loss-given default for type 1 exposures, which includes provision for 'collateral' in relation to the reinsurance arrangements to be deducted from the gross risk.

A number of P&I Clubs have reinsurance arrangements with 'dedicated reinsurers'. These arrangements include provisions that give the Club a contractual right to cancel the reinsurance arrangements at any time and require the dedicated reinsurer immediately to transfer its assets and liabilities to the Club. They will generally also provide legally enforceable collateral arrangements that ensure that these provisions can be enforced in practice.

The IG believes that such contractual security arrangements meet the definition of 'collateral' set out in CP 31 *SCR standard formula – Allowance for Financial Mitigation Techniques*, at Paras 3.59 *et seq* and therefore that in the calculation of loss given default in relation to balances with dedicated reinsurers, the full effect of the security arrangements can be taken into account.

CEIOPS will be aware that the IG and individual Clubs have raised the

and enforceability), Principle 2 of CP 52 and Principle 1 of CP 31 (Economic effect over legal form) apply so that there is no effective risk transfer (Principle 1 of CP 52) and the proposed treatment of dedicated reinsurers should apply.

			issue of the treatment of dedicated reinsurers both in the context of QIS 4 and the Framework Directive. The IG proposed amendments to Articles 13, 80 and 105 of the Directive in order to ensure that the treatment of Clubs' exposures to their dedicated reinsurers was appropriate; however, these proposals were not adopted. In the light of the treatment suggested by CP28, which the IG has interpreted as set out above, this issue may now be properly addressed and hence the IG is supportive of CEIOPS's proposed approach. The references to the importance of 'economic effect over legal form' set out in para 3.41 of CP 31 reinforce the IG's view that a Club's dedicated reinsurer should be treated for solvency purposes as being indistinguishable from the Club itself (which is the economic effect of the structure) and that the risks arising (i.e. the exposure to the dedicated reinsurer's assets) should be reflected within a market risk charge, as though those assets were those of the Club itself. This would appear to fulfil the requirements of Para 3.42.	
174.	Deloitte Touche Tohmatsu	3.77	The collateral within the loss-given-default calculation is assumed to be risk free, although we note that this is unlikely to be the case in practice. For example, letters of credit from banks may form part of the collateral, and as such these will need to have an element of counterparty default risk applied to them. Because these are contingent assets, the appropriate recovery rate to apply is (1-	Partially agreed. See revised text.

			RRre)*(1-RRco) where RRco is the recovery rate for the collateral counterparty. In practice this is likely to have a minimal impact, unless the collateral is with a poor quality counterparty. Such an approach would be consistent with the treatment of including an allowance for the risks associated with a particular risk mitigation technique.	
175.	Lloyd's	3.77	The collateral within the loss-given-default calculation is assumed to be risk free which is unlikely to be the case in practice. For example, letters of credit from banks may be part of the collateral, and these need to have an element of counterparty default risk applied to them. These are contingent assets, and therefore the appropriate recovery rate to apply is (1-RRre)*(1-RRco) where RRco is the recovery rate for the collateral counterparty. In practice the collateral will generally be of good quality and expected recoveries high but it should not be assumed to be 100% or should explicitly be included elsewhere in the credit risk module.	Partially agreed. See revised text.
176.	KPMG ELLP	3.77	With some risk mitigating contracts, there is a further associated risk where the terms and conditions of the contracts are favourable to the (re)insurer, which in the event of default by the counterparty, would result in an increase in the expected future outgo of the (re)insurer. This is currently not captured in the SCR. An example is where reinsurance has been negotiated on fixed risk rates which over time have proved to be lower than the actual cost of providing the cover. If the reinsurance cover no longer applies after the default of the reinsurer, this would reduce the profit in future and increase technical provisions.	Noted. The expected profit of the cedent caused by difference of the fixed risk rates and the actual costs would be allowed for in the reinsurance recoverables. Therefore, the risk that the expected profit will not be earned is captured in the loss-given-default.

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177.	CRO-Forum	3.77	*"For a reinsurance arrangement or a securitisation, the loss-given-default LGDi should be calculated as follows:* *LGDi = max((1-RRre)·(Recoverablesi + RMre,i) – Collaterali; 0)"* Although this formula for loss measurement may have practical benefit, the CRO Forum would like to point out that the standard financial economics formula is Exposure = Market Consistent Value of the contract with the counterparty – Collateral or other risk mitigating factors to the credit risk of the counterparty. The Market Consistent Value of the Contract would take into account expected recoveries but also the Market Value Margin for the business in question. Companies wishing to adopt this principle based approach to credit exposure (same exposure assessment done for investment assets such as bonds and loans) should be allowed.	Not agreed. The inclusion of the risk margin in the loss-given-default would cause severe practical problems as the calculation of the margin usually requires the knowledge of the current SCR. However, the disregarding of this part of the exposure may be taken into account implicitly in the calibration of the risk factors.
178.	Lloyd's	3.78	We agree that set off should be allowed for and any exposure to counterparties should be net of set off.	Noted.
179.	Dutch Actuarial Society	3.78 & 3.92	Although it seems logical to net recoverables with liabilities towards the same legal entity, there could be legal issues which make it difficult to translate to a yes or no towards netting. We advice to state netting is allowed per definition to prevent different interpretations by the different (re)insurance undertakings in case it is legally accepted/acceptable.	Partly agreed. If the legal situation in relation to netting is unclear, then no netting should be allowed for. See revised text.
180.	PEARL GROUP LIMITED	3.81	We would like more detail on how this approximation would be calculated. We have assumed that the capital requirement for market risk without amendments implies that risk mitigating instruments have been taken into account, but believe that this statement needs to be made clearer.	The definition of the term RM is dealt with in CP 51.

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181.	ABI	3.81	We would like more detail on how this approximation would be calculated. We have assumed that the capital requirement for market risk without amendments implies that risk-mitigating instruments have been taken into account, but believe that this statement needs to be made clearer.	The definition of the term RM is dealt with in CP 51.
182.	CRO-Forum	3.85/6	*"An economic approach should be taken in order to decide whether counterparties are independent or not. […]* *The legal entities of the group or the conglomerate should be treated as one counterparty in the calculation of the capital requirement."* The CRO-Forum supports the requirement that an economic approach should be taken in order to decide whether counterparties are independent or not. The conclusion, however, that all legal entities of a financial conglomerate should be treated as a single counterparty may not be justified in certain circumstances.	Not agreed. A partial internal model could be used to model the dependence structure within the financial conglomerate in a more sophisticated manner.
183.	Deloitte Touche Tohmatsu	3.86	The advice proposed suggests that members of the same financial group should be aggregated (i.e. assumed to be 100% correlated) for the purposes of counterparty default assessment. We believe that this approach may prove to be too inflexible for some firms, as it fails to recognise the full spectrum of capital structures of insurance organisations, particularly where there is ring-fencing between elements of a group. We suggest that while 100% is the standard correlation factor to assume, flexibility should be provided in the Level 2 measures to allow supervisors to agree on a case-by-case basis a lower figure in certain prescribed circumstances, which should be set out and defined in Level 3 guidance.	See resolution of comment 182.

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184.	Lloyd's	3.86	We agree that testing for independence is important. These proposals suggest that members of the same financial group should be aggregated (assumed to be 100% correlated) for the purposes of counterparty default assessment. We think that this approach may prove too inflexible for some firms, as it fails to recognise the spectrum of capital structures of insurance organisations, particularly where there is ring-fencing between elements of a group. We suggest that while 100% is the standard correlation factor to assume, flexibility should be provided in the Level 2 measures to allow supervisors to agree on a case-by-case basis a lower figure in certain circumstances that will be set out in Level 3 guidance.	See resolution of comment 182.
185.	Dutch Actuarial Society	3.86	It makes sense to take into account dependencies of counterparties which belong to the same financial conglomerate. However, treating them as one counterparty seems a high penalty. Especially taking into account each legal entity has to oblige to the local supervisory rules including capital restrictions. Also it goes by diversification benefits between the counterparties which belong to the same financial conglomerate. We advice to incorporate a mitigating factor for counterparties which belong to the same financial conglomerate.	See resolution of comment 182.
186.	KPMG ELLP	3.88	It is unclear how this approach would operate for unrated entities. While the CP does suggest that the counterparty in a type 1 exposure is **likely** to be rated, this does not necessarily need to be the case. Consideration is needed as to the calculation required in respect of unrated entities.	Ratings are dealt with in CP 51.
187.	Dutch Actuarial Society	3.89	The formula does not give an explanation of the term k. Shouldn't in the formula z_i be replaced by z_j and y_i by y_j, which is in	The term k is a summation index which runs over all rating classes. Agreed. Regarding the indices see

			line with annex A?	revised formula.
188.	PEARL GROUP LIMITED	3.91	The risk factor x only relates to diversification effects and so assumes that the entire amount is available to be lost (except for any amount that has been diversified) as the loss given default. This may result in under-estimation or over-estimation if x is not a robust parameter.	Calibration is dealt with in CP 51.
189.	Lloyd's	3.91	We agree that one single factor would be appropriate for type 2 exposures and would reiterate how this places great reliance on the calibration method that is, as yet, undefined.	Noted. Calibration is dealt with in CP 51.
190.	ABI	3.91	The risk factor x only relates to diversification effects and so assumes that the entire amount is available to be lost (except for any amount that has been diversified) as the loss given default. This may result in under-estimation or over-estimation if x is not a robust parameter.	Calibration is dealt with in CP 51.
191.	Lloyd's	3.92	We agree and note that the same comments on the treatment of collateral and set off will apply as they did for type 1 exposures in paras 3.77 and 3.78.	Noted.
192.	CRO-Forum	B.5	The table indicate that capital requirements for the different rating categories are smoothed compare to the QIS4 approach. Capital charges for the ratings AAA to A increase, capital charges for the ratings BBB to B decrease. The factor from A to BBB decreases from approx. 5 to approx. 2. We believe this does not reflect the significant difference in default probabilities between A rated and BBB rated companies (factor between 3 and 4). The calibration should also be checked against the calibration of the spread risk module.	Calibration is dealt with in CP 51.
193.	CEA	B.9	Formula is missing	Paragraph B.9 refers to the formula defined in paragraphs B.10-11. See revised text.

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