Summary of comments on CEIOPS-CP-31/09 CEIOPS-SEC-95/09

Consultation Paper on the Draft L2 Advice on SCR Standard Formula – Allowance for financial mitigation techniques

CEIOPS would like to thank **AVIVA, International Group of P&I Clubs (P&I), Pearl group limited (Pearl), FFSA, Lloyd's, International Underwriting Association of London (IUAL), Gesamtverband der Deutschen Versicherungswirtschaft (GDV), European Union member firms of Deloitte Touche Tohmatsu (Deloitte), Dublin International Insurance & Management Association (DIMA), Ireland's Solvency 2 Group, excluding representatives from the Department of Finance and the Financial Regulator (IE S2 Group), CRO Forum, Groupe Consultatif (GC), PricewaterhouseCoopers LLP UK (PwC), Unespa, ABI, Munich Re, Oliver Wyman, AMICE, CEA**

The numbering of the paragraphs refers to Consultation Paper No. 31 (CEIOPS-CP-31/09).

No.	Name	Reference	Comment	Resolution
1	AVIVA	General comment	This CP places great reliance on the documentation of financial mitigation techniques including related procedures. This requirement should be applied proportionately, taking account of the materiality and complexity of the financial mitigation techniques. The CP is focused on financial mitigation techniques. Reinsurance, and non-financial mitigation techniques have not been considered. The scope of financial mitigation techniques is not clear. Additionally, we would welcome further guidance on the recognition of mitigation techniques in different risk modules as the lack of clarity	Agreed. A reference to the application of the principles shall be introduced Noted See June wave of level 2 advices Clarification of the scope shall be introduced It is unclear the rationale of this comment. It should be necessary more concrete identification of possible 'issues in the future'

			may cause an issue in the future.	
2	P&I	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 Appreciated the general support
3	Pearl	General comment	We welcome the opportunity to comment on the CEIOPS' suggested Level 2 advice on allowance for financial mitigation techniques within the SCR Standard formula. This CP places great reliance on the documentation of financial mitigation techniques including related procedures. This requirement should be applied proportionately, taking account of the materiality and complexity of the financial mitigation techniques. The Directive asks for implementing measures for risk mitigation techniques, but the CP is focused on financial mitigation techniques. Reinsurance, and non-financial mitigation techniques have not been considered. The scope of financial mitigation techniques is not clear. Examples would help.	Agreed. See comment 1 Noted See comment 1
4	FFSA	GENERAL COMMENT	The philosophy behind Solvency II is not to restrict eligibility of assets. CEIOPS should state that all financial mitigation techniques will be fully allowed for ("by default") in the Solvency II calculation. In consequence, the full mitigation effect of all financial mitigation techniques should be recognised in the SCR calculation (as well as in the BE calculation) for its economic value. In parallel, restrictions to the	Disagreed Article 109(1f) of the Level 1 text is clear in the sense that financial mitigation techniques should meet some qualitative criteria.

			risk mitigation effect should also be taken into account in the SCR calculation (as well as in the BE calculation) for their economic value.	The approach of the advice is a consequence of the level 1 text and cross-sector consistent
5	FFSA	General comment	We believe that the level of guidance is appropriate for level2.	Noted Appreciated this support
6	Lloyd's	General comment	Lloyd's is in general agreement with the principles outlined in the consultation paper and believes they provide a good framework for the allowance of financial risk mitigation techniques. The five principles are all important and should be considered. We also believe that two of the overlying key principles outlined in the consultation paper are key and should be emphasised as such: - The undertaking itself is responsible for assessing and implementing appropriate risk mitigation techniques to apply to the undertaking. - The concept of substance over form (in para 3.23) is applied and that any risk mitigation technique should be chosen based on the risk management of the company rather than to simply reduce regulatory capital. We would like to see some further clarity on the treatment of issuers rated below BBB, especially where it involves collateral. For example, a fully collateralised transaction involving an unrated issuer should be allowed for in the SCR calculations but would not be as currently worded.	Noted Appreciated this support Agreed. Agreed. The wording shall be amended accordingly to clarify this case

			Lloyd's also strongly believes the principles presented in the consultation paper would not apply to reinsurance for various reasons and do not think there is a natural extension from financial risk mitigation techniques to reinsurance. In QIS4 there was clear distinction between financial risk mitigation techniques and reinsurance and we believe for good reason. We therefore do not see endorsement of this consultation paper as a guide to endorsement of similar proposals for reinsurance. Finally, we believe some improvement in clarity through amendments to language could be achieved and have made some suggestions below. These suggestions are entirely designed to help in drafting and should not be seen as criticisms at all. A good example of this is the use of the phrase "financial mitigation techniques" throughout the paper and we believe this should be replaced with "financial risk mitigation techniques" to add clarity.	Noted See June wave of advices, including a specific advice on reinsurance mitigation Noted Drafting suggestions are welcome. The expression '*financial mitigation techniques*' is used since it is the reflected in the legal text of article 109(1f)
7	IUAL	General comment	We are supportive of the five principles outline. However, we also firmly believe that innovative or sophisticated risk management techniques should not become prohibitively expensive, nor excessively burdensome to use through an overly stringent interpretation of those principles; where innovative or sophisticated techniques are justified and well documented, these should be permissible. We note that reinsurance is considered out of scope from this consultation paper, although we would ask CEIOPS to clarify whether they might consider there to be some read across to reinsurance. Our	Noted The text pretends to be neutral at this respect. It would be necessary more concrete suggestions. It is unclear which parts of the advice may prejudge future mitigation techniques Noted See June wave of advices,

			tentative view is that reinsurance should be considered distinctly, and these principles should not necessarily read-across to reinsurance automatically; however, we can also see some merit in the sharing of principles, where they are appropriate.	including a specific advice on reinsurance mitigation
8	GDV	General comment	The GDV supports the comments given by the CEA. In particular we would like to emphasize the following issues: All kinds of financial mitigation techniques should be considered with its full economic value in the SCR calculation. This also holds for those techniques where some basic risk remains. This consultation paper covers only financial mitigation, a respective consultation paper on re-insurance is still missing.	Disagreed See comment 4 Noted See June wave of advices, including a specific advice on reinsurance mitigation
9	Deloitte	General comment	We agree with the overall principle of economic substance over legal form.	Noted Appreciated this support
10	DIMA	General comment	While recognising the aspiration to avoid a distinction between instruments and techniques based on legal form, it may still be useful in distinguishing between hedges, guarantees and mitigation as these are somewhat distinct concepts and tools. The principles militate against the implementation of a dynamic hedge regime for companies looking to set capital under the SCR. Noting that Solvency II is borrowing to a certain extent from the Basle principles, it	Disagreed This comment seems to refer to the recognition of dynamic hedging. CEIOPS view is that dynamic hedging techniques are complex techniques, which involve

			would be appropriate to give equivalent credit to equivalent risk mitigation regimes for market risks which would support credit for dynamic hedging. Subject to a requirement to have an embedded system, that meets the requirements of "use" and subject to requirements as to hedge policy implementation and audit, then provision of credit for dynamic hedge systems is warranted. If the challenge is one of supervisory capability to assess and weigh the suitability of a dynamic hedge regime perhaps it is worth noting that companies seeking to implement a dynamic hedging policy will in parallel "need to" / "seek to" implement an internal model as an alternative to the SCR given this limitation. This will put an onus on regulators to be in a position to assess the effectiveness of hedging policies in any event. This would appear somewhat artificial in so far as dynamic hedging is either a credible risk management tool or it is not. Thus if the challenge is in the visibility or observability of the hedge effectiveness of a program then this challenge will arise equally whether under an SCR or an internal models approach. If there is to be a significant impediment to the allowance for dynamic hedge effectiveness within the EU then this will solely serve to drive the challenge overseas/outside the EU which will be contrary to the supervisory and market functioning aims of Solvency II.	complex risks (i.e. operational risks), as the crisis has evidenced. Therefore, within the context of a standard calculation of the SCR it has no sense to allow the effects of dynamic hedge since: a) They are not applied for almost none of the likely users of the standard calculation on the SCR b) Dynamic hedge involves such a complex risks (among others operational risks), that its allowance should be restricted to internal models, provided they capture appropriately not only the effect of the dynamic hedge, but also the associated risks these techniques creates (in particular operational risks)
11	IE S2 Group	General comment	While recognising the aspiration to avoid a distinction between instruments and techniques based on legal form it may still be useful in	Disagreed

			distinguishing between hedges, guarantees and mitigation as these are somewhat distinct concepts and tools. The principles militate against the implementation of a Dynamic hedge regime for companies looking to set capital under the SCR. Noting that we are borrowing to a certain extent from the Basel principles, would it not seem appropriate to give equivalent credit to equivalent risk mitigation regimes for market risks which would support credit for Dynamic hedging ? Subject to a requirement to have an embedded system that meets the requirements of "use" and subject to requirements as to hedge policy implementation and audit then provision of credit for dynamic hedge systems is warranted. If the challenge is one of supervisory capability to assess and weigh the suitability of a dynamic hedge regime perhaps it is worth noting that companies seeking to implement a dynamic hedging policy will in parallel "need to" / "seek to" implement an internal model as an alternative to the SCR given this limitation. This will put an onus on Regulators to be in a position to assess the effectiveness of hedging policies in any event. This would appear somewhat artificial in so far as Dynamic Hedging is either a credible risk management tool or it is not. Thus if the challenge is in the visibility or observability of the hedge effectiveness of a program then this challenge will arise equally whether under an SCR or an Internal Models approach. If there is to be a significant impediment to the allowance for dynamic	Repetition of comment 10

			hedge effectiveness within the EU then this will solely serve to drive the challenge overseas/outside the EU which will be contrary to the supervisory and market functioning aims of Solvency 2.	
12	CRO	General comment	The CRO Forum is in general supportive of CP31, which provides a principles-based approach for allowing of risk mitigation techniques in the Standard Model. We hope that this will encourage companies to develop and improve techniques focused on reducing real risk, rather than simply using techniques previously prescribed by regulation. We note that CEIOPS will provide more detailed advice on the quantitative treatment of mitigation techniques at a later stage at Level 3. We will comment at that point. But, we would welcome more clarity on the definition and scope of "financial mitigation techniques" already at this stage, through appropriate examples. We see one major topic of disagreement regarding the non recognition of dynamic hedging strategies in the standard formula (para 3.25), as CEIOPS considers an instantaneous shock, which effectively excludes any benefit from dynamic hedging, rather than a more realistic shock (spread over a short period but not instantaneous). This is a significant current issue for many insurers, and the CRO Forum would seek further discussion in this regard. This concern has been also expressed in our response to CP 32 'Future Management Actions'. We also take the opportunity to stress that any restriction on recognition in the Standard Model should not be carried over to application in Internal Models We note also some overlaps/ discrepancies between this CP and CP 32 on 'Future management actions', such as definition, documentation and	Noted Appreciated this support Agreed Disagreed See comment 10 Disagreed

			recognition criteria and process; we would welcome a better convergence for the final advice. Some generic wording (eg "a sufficient number of appropriately qualified staff", "sufficient legal review", "material", "generally applied procedures, "generally admitted criteria") may need further guidance in the final advice.	We do not observe discrepancies, but a joint review shall be carried out in any case. Noted Due its technical nature, this details may be developed, if necessary, as part of level 3 guidance
13	RSA	General comment	Broadly sensible proposals.	Noted Appreciated this support
14	GC	General comment	The concept of "Financial risk mitigation technique" needs to be clearly defined and the difference to (if any) "processes and controls used to manage investment risks" clearly explained.	Agreed This clarification shall be considered in the final version
15	PwC	General comment	Contractual Period: while the CP discusses basis risk, further clarification could be provided regarding potential mismatches between 1) the subject period of the capital requirement calculation ("subject period") and 2) the period of the financial mitigation contract ("contract period"). For instance, the treatment of the following situations could be further clarified 1) financial mitigation contract not yet in place when modelling is done but due to incept and cover the subject period, 2) financial mitigation contract partially covering the subject period, 3) financial mitigation contract partially covering the subject period but expected to be renewed to covered the entire subject period.	Agreed This clarifications shall be considered in the final version

16	PwC	General comment	Shared Claims: again, while the paper discusses basis risk, further clarification could be provided regarding financial mitigation techniques covering the entity under considerations, as well as other entities (typically within the same group, but not necessarily subject to Solvency 2). The entity under consideration may not be able to fully recover from the financial mitigation technique, if another entity also claims on it.	Agreed The treatment of this case shall be considered in the final version
17	Unespa	General Comments	**Financial Mitigation Techniques** We consider it positive that the Consultation Paper recognises that the use of financial risk mitigation techniques by undertakings should as a general principle be translated into an appropriate reduction in capital requirements. The above notwithstanding, it is also necessary to add certain modifications to some of the requirements included in the five essential principles to be met by financial mitigation techniques in order for them to permit an adequate reduction in capital requirements for the insurance company; these are detailed below. The main criticism of the approach in the Consultation Paper is that the regulation proposal seems to establish that the financial mitigation measures should comply with each and every one of the requirements to the same degree in order to permit a reduction in capital requirements. In other words, the Consultation Paper seems to be	

			saying that if an instrument does not meet in full any one of the five principles then it will automatically be excluded from reducing capital requirements. This "all-or-nothing" position does not correspond to the economic approach established in the Directive, as, for example, the capacity of an instrument which failed to meet one of the five principles in full (whilst complying with the other four) to reduce capital requirements in part should be recognised. The economic value of all financial mitigation techniques should therefore be recognised in the calculation of SCR. Parallel to this, the economic value of all risk mitigation restrictions (the 5 principles) should also be taken into account when calculating the SCR (irrespective of whether the mitigation instruments mitigate this in part or in full). Finally, and although progress has been made in establishing how to calculate the reduction in capital requirements by the use of financial risk mitigation techniques, we consider that it is still necessary to have more details and clarification of the level 2 requirements in order to achieve maximum possible harmonisation on this issue in all jurisdictions.	Disagreed Principles in conjunction are essential to guarantee the effectiveness of the risk transfer. Therefore it is appropriate to allow the mitigation technique only when all the principles are met. Disagreed See comment 4 Agreed Clarifications shall be introduced according previous comments. Technical details may be better allocated within level 3 guidance.

<table>
<tr><td>18</td><td>ABI</td><td>General comment</td><td>

We welcome this paper which provides sensible proposals for the allowance of financial mitigation techniques. We believe the conditions and responsibilities set out by CEIOPS to be appropriate but provide some more detailed comments in the attached.
Proportionality. This consultation paper places great reliance on the documentation of financial mitigation techniques including related procedures. This requirement should be applied proportionately, taking account of the materiality and complexity of the financial mitigation techniques.
Scope. We believe it is critical that the level 2 implementing measure and level 3 guidance should be set at a sufficiently high level in order to make sure that evolving and new instruments would not fall out of its scope. We also firmly believe that innovative or sophisticated risk management techniques should not become prohibitively expensive, nor excessively burdensome to use through an overly stringent interpretation of those principles; where innovative or sophisticated techniques are justified and well documented, these should be permissible.
Perfect / effective matching. We believe a perfect match is impossible to ascertain and we therefore think an effective match would be more relevant when assessing the exposure.
Broader considerations when allowing for financial mitigation techniques. Pre-conditions applying to the use of financial mitigation techniques should be alleviated when the

</td><td>Noted
Appreciated this support

Agreed
Proportionality should be included

Noted
See comment 7

Disagreed.

Disagreed</td></tr>
</table>

			technique considered constitutes an accepted practice.	An 'accepted practice' is a fuzzy concept whose rationale does not justify its inclusion in the advice. This type of blurred concepts does not seem compatible with a prudent and harmonized approach
			• **Basis risk**. We should acknowledge basis risk but not necessarily exclude the instrument. Instead, we should allow for a recognition of the risk mitigation it provides.	Disagreed. The standard formula shall not allow those financial mitigation techniques that generate material risks not explicitly or sufficiently captured in the standard formula
			• **Liquidity and credit principles.** What is important is that an effective risk transfer happens following the implementation of various financial mitigation techniques. Again, the risk transferability should be assessed but there should be no investment rules introduced for assets with financial risk mitigation effects.ç	Disagreed Solvency 2 aims to guarantee the solvency in a prospective manner. Liquidity and credit principles are essential to achieve this. See also comment 4 and cross-sector consistency

			• The CP is focused on financial mitigation techniques. **Reinsurance, and non-financial mitigation techniques** have not been covered. However, we agree that reinsurance should be considered distinctly, and these principles should not necessarily read-across to reinsurance automatically; although some elements may be common to both. Further, we would welcome further guidance on the recognition of mitigation techniques in different risk modules as the lack of clarity may cause an issue in the future. • Finally, We note also some overlaps / discrepancies between this CP and **CP32 on 'Future management actions'**, such as definition, documentation and recognition criteria and process; we would welcome a better convergence for the final advice.	Noted. See June second wave of advices Disagreed We do not observe discrepancies, but a joint review shall be carried out in any case
19	Munich Re	General comment	MR is supportive of CP 31 and the high level principles outlined. There are, however, some areas of concern, especially as it is currently unclear to us how these principles will be applied in the context of internal models: • It is not clear whether these principles will apart from capital market solutions will also apply to other forms of risk mitigation, like reinsurance. • Risk mitigation techniques should be in general allowed for in the Solvency II calculation on an economic basis. Even if risk	Noted. Appreciated the support Noted. See June second wave of advices Disagreed

			mitigation is only partial due to basis risk, it should nevertheless be recognized appropriately. • Dynamic hedging strategies should be reflected. We would seek further guidance in this regard. • • This CP places great reliance on the documentation of financial mitigation techniques including related procedures. This requirement should be applied proportionately, taking account of the materiality and complexity of the financial mitigation techniques.	See previous comments Disagreed See comment 10 Agreed See comment 18
20			Confidential comment deleted.	
21			Confidential comment deleted.	
22	Oliver Wyman	General comment	Overall, we find that the consultation paper provides the advice requested in Article 109 (1) (f) of the Level 1 text. We agree with scope and overall philosophy of this consultation paper on allowance for financial mitigation techniques in the application of the SCR standard formula. Hence, our comments address specific aspects of the advice given. As set out in paragraph 1.3 of the consultation paper, the advice on qualitative requirements that financial mitigation techniques must meet cannot be separated from the provisions regarding the quantitative treatment of the mitigation techniques, as requested in Article 109 (1)	Noted. Appreciated the support

			(e) of the Level 1 text. Hence, a final assessment of the advice given in Consultation Paper 31-09 can only take place once these quantitative requirements have been published.	
23	AMICE	General comment	AMICE members welcome the introduction of different principles defined in the paper which recognise the variety of existing financial mitigation techniques. However, we would appreciate if these requirements could be completed by including new elements from the lessons learnt from the financial crisis.	Agreed. A revision in this sense will be carried out
24	CEA	Key comments	**There should not be a restrictive application of the "prudent person principle"** We are concerned that there appears to be a more restrictive application of the *"prudent person"* investment principle in the treatment of assets considered when being used as *"financial mitigation techniques".* Such an approach could lead to inconsistencies between the treatments of different instruments. **Instruments should be appropriately recognised in the SCR.** All financial mitigation techniques should be fully allowed for on an economic basis. The consultation paper implies that instruments which do not meet the five principles stated in the paper in full will not generate reductions in capital requirements. We strongly believe that the effect of all financial mitigation techniques should be recognised in the SCR (as well as in the Best Estimate) for their economic value. Correspondingly, all restrictions in the risk mitigation effects provided by these instruments should also be taken into account in the SCR (as	Disagreed There is no restrictive approach. See comment 4 Disagreed See comment 4

			well as in the Best Estimate). **We have concerns with the proposal that financial mitigation techniques are completely ruled out of the SCR if there is a material basis risk. Techniques that do not perfectly match exposure should be recognized for their economic value.** **Care is needed in judging the liquidity and credit principles.** What is important is that an effective risk transfer happens following the implementation of various financial mitigation techniques.	Disagreed See comment 18 Disagreed. See comment 18
25	CEA	General comments	The CEA welcomes the high level principles set out. In particular the CEA appreciates the principle of "substance over form". **The philosophy behind Solvency II is not to restrict eligibility of assets**. There appears to be a more restrictive application of the *"prudent person"* investment principle in the treatment of assets considered *"financial mitigation technique"* which could lead to inconsistencies between instruments deemed to need not meet the principles and those required to meet the principles but failing to do so. **All financial mitigation techniques should be fully allowed for in the Solvency II calculation on an economic basis**. The CP implies that instruments not meeting in full the five principles will not generate reductions in capital requirements. We believe though that the mitigation effect of all financial mitigation techniques should be appropriately recognised in the SCR calculation (as well as in the BE calculation) for its economic value. In parallel, all restrictions to the risk	Disagreed. See comment 4 Disagreed. See comment 4

			mitigation effect should also be taken into account in the SCR calculation (as well as in the BE calculation) for their economic value. **There are concerns that financial mitigation techniques are fully ruled out of the SCR calculation if basis risk is material.** CEIOPS has taken the approach that financial mitigation techniques should be only included in the standard model SCR calculation only if the assets match perfectly the exposures of the undertaking or the basis risk is not material to the mitigation effect. This seems to run counter to a number of principles under Solvency II as follows: • Solvency II is designed to encourage and reflect good risk management practices. Even where partial mitigation is achieved it should be allowed for within the standard model SCR. • In the underlying equity stress tests, there is no allowance for basis risk compared to the indices used. The scope and definition of *"financial risk mitigation"* are not fully clear. We believe it is critical that the level 2 implementing measure and level 3 guidance should be set at a sufficiently high level in order to make sure that evolving and new instruments would not fall out of its scope This CP places great reliance on the documentation of financial mitigation techniques including related procedures. This requirement should be applied proportionately, taking account of the materiality and	Disagreed. See comment 18 Noted. Agreed See comments above

			complexity of the financial mitigation techniques. We understand that this CP applies only to the case of the standard formula. Though it is not explicitly stated in some parts of the advice (e.g. paragraphs 3.29-3.34) we therefore assume that no advice is being given in relation to internal model users.	Agreed Correctly understood. Clearer statement at this respect will be introduced
26	ABI	Para 1.2	**Securitisation** '…regarding 'securitisation' this advice should be understood as a first step.' We note that securitisation will require further attention. We encourage CEIOPS to consider the various forms and uses of securitisation in risk mitigation. Measures in other sectors should be considered but must be carefully assessed to derive an appropriate and proportionate application to insurance. In particular we note that securitisation of insurance risk has many material differences to the credit risk applications that are currently the focus of attention.	Noted. 'Securitization' is not within the scope of this advice, as explained at its beginning. Cross-sector consistency requires to coordinate the advice on this topic with developments in other financial sectors
27	FFSA	1.2	We are awaiting CEIOPS proposals on securitisation with interest.	Noted. See comment 26
28	RSA	Securitisation	How is this captured? Assessing the risk transfer of securitisation is extremely difficult. It is unclear how this is treated.	Noted. See comment 26

29	CEA	Para 1.2	We are waiting with interest CEIOPS' proposals on securitisation. We expect such a proposal will take into consideration the specificities of insurance securitization	Noted. See comment 26
30	Munich Re	Para 2.1	It is currently unclear to us whether there will be guidance for other risk mitigation techniques, like reinsurance and other non-financial mitigation techniques	Noted. See comments above
31	CEA	Para 2.1	The draft advice is on the treatment of financial mitigation techniques although the advice is in support of Article 109 1f) which refers only to *"risk mitigation techniques".* Will there be other guidance for other risk mitigation techniques, like reinsurance and other non-financial mitigation techniques?	Noted. See comments above
32	CRO	Para 3.7	*"In one undertaking's view [...] all types of risk mitigation (financial risk mitigation, reinsurance, insurance) should be subject to the same general principles both under the SCR standard formula and under internal models.' This comment will be addressed in separate CEIOPS advice regarding internal models."* The paper only deals with standard models, but it will be important to have some consistency with what is appropriate for internal models (noting that a greater degree of freedom of allowable techniques and treatments should be permitted with internal models, subject to the Internal Model approval requirements).	Noted.
33	IUAL	Para 3.8	We note that "specific risk mitigation techniques…would need to be covered as part of Level 3 guidance", and also note that reinsurance is	Noted. See June second wave of advices

			considered out of the scope of this advice. We support this principle, although we would like to seek clarification that this extends to all forms of reinsurance.	
34	Pearl	Para 3.8	'More level of detail on specific mitigation techniques or rather complex and also evolving instruments would need to be covered as part of Level 3 guidance': We would agree this needs to be as much principles based as possible as the techniques will evolve.	Noted.
35	ABI	Para 3.8	'More level of detail on specific mitigation techniques or rather complex and also evolving instruments would need to be covered as part of Level 3 guidance': we agree with this and would further emphasize that this needs to be as much principles based as possible as the techniques will evolve. If this were a new practice for the undertaking we would imagine that more information would be shared with supervisors.	Noted. Repeated. See comments above
36	CEA	Para 3.8	We would agree this advice needs to be as much principles based as possible as the techniques will evolve. If this were a new practice for the undertaking we would imagine that more information would be shared with supervisors.	Noted. Repeated. See comments above
37	IUAL	Para 3.9	We agree that undertakings should have the primary responsibility for compliance with regard to the treatment of financial mitigation techniques for the purposes of the SCR.	Noted. Appreciated the support
38	ABI	Para 3.9	We agree that undertakings should have the primary responsibility for compliance with regard to the treatment of financial mitigation techniques for the purposes of the SCR.	Noted. Appreciated the support
39	CRO	Para 3.11	*3.11: ""Alternative risk transfer instruments such as catastrophe bonds are not adequately reflected in QIS4.". CEIOPS will further analyse the*	Noted.

		(also addressed in 1.2)	*treatment of 'securitisation', including catastrophe bonds as reflected in paragraph 1.2."* *1.2: "This advice covers financial mitigation techniques mentioned in article 109 (1) (f), including in its scope instruments such as financial derivatives (i.e. futures, options, credit derivatives). Nevertheless, regarding 'securitisation' this advice should be understood as a first step. The approach will be further refined, taking into account initiatives that are currently being discussed at EU level in order to ensure cross-sectoral consistency."* Regarding 'securitization', we welcome the current initiative at EU level to ensure cross-sectoral consistency and are waiting further CEIOPS' guidance on this issue.	See comment 26
40	CRO	Para 3.17	*"One of the main objectives of the Solvency 2 project is to encourage undertakings to implement an efficient and reliable risk management, which implies a diversity of coordinated qualitative and quantitative actions on the overall entity."* We feel that a good definition of financial mitigation techniques is missing. Some of these techniques are explicit on the balance sheet (financial derivatives or reinsurance). Other techniques such as dynamic hedging and discretionary profit sharing should be included in the definition. Double counting should be avoided.	Disagreed. See comments above, among others comments 10 and 14 Nevertheless clarification of the concept is needed
41	Pearl	Para 3.20	How would the "appropriate reduction work"? There are various risk mitigation techniques that might apply but require time to react for them to be implemented, for example if there is a stop-loss contract in	Disagreed.

			place. We believe that these contracts should be assumed to have some effect but that they may not be 100% effective under certain stress scenarios.	See comments above
42	Lloyd's	Para 3.23	Lloyd's strongly agrees with the general principles outlined here and especially that it is the responsibility of the undertaking itself for the assessment (and implementation) of appropriate risk mitigation techniques and the principle of substance over form.	Noted. Appreciated the support
43	Oliver Wyman	Para 3.24 Para 3.25 Para 3.26 Para 3.40	In our view the "financial risk mitigating" effects of instruments cannot be divorced from the "processes and controls" which underlie their management where effective risk mitigation is achieved only through active management of said instruments. In practice, this will apply to all instruments managed under the aegis of a dynamic hedging strategy. A good example of such a strategy is a Delta-hedging program supporting a block of variable annuity business – such a dynamic strategy is designed to work well when instruments are rebalanced frequently to compensate for mismatches in convexity and other market sensitivities that cannot be statically hedged with readily traded instruments. However, we also recognise that there are significant benefits to simplifying the SCR calculation. Therefore, we feel that while separating the financial risk mitigation effects of instruments from any underlying processes and controls could be forced in the SCR calculation, such a separation should not be required in (re)insurer's internal models. The additional controls and oversight required for internal model approval should ensure that any assumptions around "processes and controls" used in the internal model meet the standards of objectivity, realism	Disagreed. See comment 10 Noted

			and verifiability. Forcing such an artificial separation in the internal model could have a number of negative consequences: a) Incentivise (re)insurance undertakings to employ economically inefficient hedging strategies which minimise capital requirements while increasing risk exposures (e.g. "over hedging" risk exposures) b) Penalise the economics of products which rely on dynamic hedging resulting in higher costs of capital and ultimately higher consumer prices for those products It is important to note that recent studies of dynamic hedging programs in the Variable Annuity business have shown that these programs can perform relatively well (relative to their hedge objectives) even in very difficult market environments.	Disagreed. This does not seem to be the experience of the recent crisis
44	AVIVA	Para 3.24	Item 3.24 and 3.25 seem to prescribe that the risk mitigating effects of equity hedges based on e.g. roll-over strategies cannot be fully recognised in the SCR. It is not clear to us what part of the financial mitigation instruments can be recognised in case the maturity is shorter than the end of the 1-year stress period. For instance if all equity put options expired before the end of the year, we are of the opinion that at least part of these options should be taken into account.	Noted. This point will be clarified in the final advice
45	GDV	3.24, 3.25	We understand that this consultation paper considers only instruments but not processes or controls as financial mitigation techniques. However, we believe that dynamic or rolling hedging programmes and	Disagreed.

			other dynamic investment strategies, like CPPI or cash-flow matching, should be considered in the SCR calculation. If such a hedging program is well documented and has proved its effectiveness then it should be considered either as financial mitigation technique or reduce the SCR in a similar way.	See comments above, among others 10 and 43. Also comment 46 below
46	Lloyd's	Para 3.24	Whilst Lloyd's agrees that allowance in the SCR is restricted to instruments (and not processes and controls of investment risk) it should not be seen to discourage sound practices in these areas.	Noted.
47	ABI	Para 3.24	Item 3.24 and 3.25 seem to prescribe that the risk mitigating effects of equity hedges based on e.g. roll-over strategies cannot be fully recognised in the SCR. It is not clear to us what part of the financial mitigation instruments can be recognised in case the maturity is shorter than the end of the 1-year stress period. For instance if all equity put options expired before the end of the year, we are of the opinion that at least part of these options should be taken into account.	Repetition of comment 44. See above
48	DIMA	3.24/3.25	There is a subtle distinction, which seems to have been missed in the example of dynamic hedging, between applying a process to actively mitigate a risk from that of the application of process which requires regular updating. The case in point being that under dynamic hedging a position may be instantaneously (Delta) hedged but would be exposed to sudden large market movements (Convexity exposure). To the extent that there is a need to regularly update the hedge position for the passage of time and movement in market levels, this constitutes a regular operational activity and appears to be adequately addressed in the guidance of 3.32 to 3.35. Any concern regarding the future availability of instruments for "roll over" is addressed through 3.49	Noted.

			where the liquidity requirement applies to both the sale and the purchase of instruments. It is fully accepted and supported that convexity exposure should not be eliminated through the presumption of instantaneous rebalancing where the test is an instantaneous test.	
49	IE S2 Group	3.24/3.25	There is a subtle distinction, which seems to have been missed in the example of dynamic hedging, between applying a process to actively mitigate a risk from that of the application of process which requires regular updating. The case in point being that under dynamic hedging a position may be instantaneously (Delta) hedged but would be exposed to sudden large market movements (Convexity exposure). To the extent that there is a need to regularly update the hedge position for the passage of time and movement in market levels constitutes a regular operational activity and appears adequately addressed in the guidance of 3.32 to 3.34 together with addition of a charge for "risks acquired in the process in accordance with 3.35. Any concern regarding the future availability of instruments for "roll over" is addressed through 3.49 where the liquidity requirement applies to both the sale and the purchase of instruments. It is fully accepted and supported that convexity exposure should not be eliminated through the presumption of instantaneous rebalancing where the test is an instantaneous test.	Repetition of comment 48. See above
50	CRO	Para 3.24 & 3.25	*"The allowance for financial risk mitigating effects in the SCR standard formula is restricted to instruments and excludes processes and controls the firm has in place to manage the investment risk."*	Disagreed. See comments above about

			"For example, where a firm has a dynamic investment strategy (for example, delta-hedging or cash-flow matching), a firm should calculate the capital charge assuming that it continues to hold its current assets during the change in financial conditions, i.e. the change in financial conditions should be treated as being an instantaneous shock." Dynamic hedging strategies are not taken into account in the SCR standard formula, as CEIOPS considers an instantaneous shock, which effectively excludes any benefit from dynamic hedging, rather than a more realistic shock (spread over a short period but not instantaneous). In the current financial crisis, dynamic hedging strategies (e.g. delta hedging) proved their mitigating role. Eg if the shock was phased in over time e.g. 1 month, then benefit of dynamic rebalancing could then be assessed. Arguably the impact of dynamic hedging could be approximately included via a lower calibration of the shock, but that would mean making some generic assumptions on average benefits of dynamic hedging, which may not always be the case. This non-recognition could lead to substantial differences with the internal model approach. This is a significant current issue for many insurers, and the CRO Forum would seek further discussion in this regard. This concern has been also expressed in our response to CP 32 'Future Management Actions'.	dynamic hedging

51	ABI	Para 3.25	We have some concerns with the non-recognition of dynamic hedging strategies in the standard formula (para 3.25), as CEIOPS considers an instantaneous shock, which effectively excludes any benefit from dynamic hedging, rather than a more realistic shock (spread over a short period but not instantaneous). We would want to ensure appropriate recognition of dynamic hedging, particularly where a firm has an internal model. This is a significant current issue for many insurers.	Disagreed. See comments above about dynamic hedging
52	GC	Para 3.26	Are management actions allowed when calculating the SCR used for estimating the market value margin?	This question is out of the scope of this advice
53	RSA	3.29 – 3.62	Conditions and responsibilities are appropriate. Key principle regarding complete analysis of functioning of technique should be the focus. Some high level guidance is needed in Level 2 on many of the industry standard mitigatants, e.g. CDS and equity hedges. For example, Level 2 should explain that a CDS is only considered a mitigation if the instrument matches the name, tenor and nominal amount of the credit exposure and that an equity hedge of the FTSE 100 is only counted as a hedge if the basket of equities it hedges are representative of at least x% of the FTSE 100 names and are within y% of the relevant weighted exposure. There should also be something on tracking error less than 2%	Agreed Clarification has been included
54	RSA	Principle 4	Why do we not link these requirements to Basel II standardised rules? The Standardised credit risk rules allow banks to calculate credit risk based on rating agency grades and nominal exposures. These requirements are global standards for unexpected loss and capital. Surely these should apply to insurers on a read across basis?	Disagreed. Principles are to a great extent consistent with Basel framework. Nevertheless an automatic link is

				not appropriate due insurance specific features
55	GC	Para 3.30	The text in the paragraph should be rephrased since it is difficult to understand.	Noted. It will be revised
56	DIMA	3.30	The summary guidance of 3.30 appropriately disallows "…the assumption of exposures……..on the mere expectancy of adopting afterwards a mitigation technique….". It would however be useful to clarify that this is a different concept from dynamic hedging that may well require rebalancing, i.e. the purchase of instruments, in the future but is far from a "mere expectation" which is perhaps more usefully considered to refer to activities such as "warehousing" of risk to be repackaged and reinsured or securitised into an as yet unidentified market with an as yet unidentified structure and price.	Disagreed. See comments above on dynamic hedging and securitization. 'This advice is a legal text and references should be as clear as possible (this does not seem the case of 'warehousing')
57	IE S2 Group	3.30	The summary guidance of 3.30 appropriately disallows "…the assumption of exposures……..on the mere expectancy of adopting afterwards a mitigation technique….". It would however be useful to clarify that this is a different concept from dynamic hedging that may well require rebalancing, i.e. the purchase of instruments, in the future but is far from a "mere expectation" which is perhaps more usefully considered to refer to activities such as "warehousing" of risk to be repackaged and reinsured or securitised into an as yet unidentified market with an as yet unidentified structure and price.	Repeated. See comment 56
58	Lloyd's	Para 3.31	Lloyd's agrees that the responsibility for the assessment and application of financial risk mitigation techniques should rest with the undertaking.	Noted. Appreciated this support

59	GC	Para 3.32	Further details specification needed on requirements on a "Complete analysis" Since liquidity risks will turn out to be of central importance, further advice is needed to define liquidity risk and liquidity risk measurement.	Noted.
60	AVIVA	3.32	From Aviva's point of view, conditions included in paragraph 3.32 are reasonable and are a good example of the requirements we would expect to meet in order to consider the use of financial mitigation techniques. Under the fourth point in the paragraph, it is unlikely that any internal procedure can "guarantee" any adverse experience, perhaps ensure would be a better wording.	Agreed. Wording will be revised
61	Deloitte	Para.3.32	The guidance indicates that, "sufficient knowledge and expertise" is required to allow for a financial mitigation technique. We would welcome clarification as to the criteria against which this would be assessed. In particular, would the concept of "fit and proper requirements" as discussed in article 42 of the directive be considered sufficient to cover this?	Agreed Clarification has been included
62	CRO	Para 3.32	*"An undertaking shall apply financial mitigation techniques only if:* *2nd bullet – It develops a written complete analysis of functioning and inherent risks of the financial mitigation technique. In particular, the underwriting shall document the legal, liquidity/termination or other risks that can derive from the financial mitigation technique, the actions adopted to face such risks and the potential consequences of the risks*	

			(i.e. in a worst-case scenario); " In general we agree with paragraph 3.32; however we would like to point out that the requirements under the second bullet should be proportionate to the size of the risk and complexity of risk mitigation techniques involved. It might be useful to distinguish between accepted practices and novel instruments or practices in defining the need for documentation and analysis	Disagreed. 'Accepted' and 'novel' instruments are vague concepts. In fact such distinction seems not relevant to relax the principles reflected in the advice
63	CRO	Para 3.32	*"An undertaking shall apply financial mitigation techniques only if:* *[…]* *There are internal procedures to guarantee that the functioning and risks of the financial mitigation technique are managed and controlled with the appropriate intensity and frequency."* This paragraph should also refer to appropriate mechanisms to ensure that the mitigation techniques can counted upon in times of stress, eg collateral calls made / due in the case of derivatives.	Agreed. Included
64	ABI	Para 3.32	We agree with the set of principles required by CEIOPS in this paragraph. However, whilst we would expect these criteria to apply rigorously to novel instruments or practices, we believe they should apply more softly when the financial mitigation technique considered constitutes an accepted practice. We would also expect this requirement to be proportionate to the nature of the technique. We would be interested to have some further guidance on the treatment of existing techniques where the written analyses may not exist. We consider the analysis of functioning and inherent risks of the	See comments 60 and 62

			financial mitigation technique to be the key pre-condition for using a financial mitigation technique and it should therefore constitute the main point of focus. Under the fourth point in the paragraph, it is unlikely that any internal procedure can "guarantee" any adverse experience, perhaps ensure would be a better wording.	
65	Munich Re	Para 3.32	The required documentation and analysis should be proportionate to the financial effects of the risks and risk mitigation techniques involved. Documentation standards could be established "at arm's length" based on existing IFRS-requirements. It could be useful to split the documentation in a general part "risk policy with descriptions of applicable risk mitigation techniques" and a specific part with actions taken. The documentation of the actions taken could then follow IFRS-requirements. A complete analysis as mentioned in 3.32 for hedging activities as usual, e.g. for equity hedges via long puts, would thus be redundant.	Agreed.
66	CEA	Para 3.32	**The CEA agrees with the principles in this paragraph and believes they should be applied proportionately to the financial effects of the risks and risk mitigation techniques involved.** We would expect these criteria to apply rigorously to novel instruments or practices, while we believe that they should apply more softly when the financial mitigation technique constitutes an accepted practice. We consider the complete analysis of functioning and inherent risks of the financial mitigation technique to be the key pre-condition for using	Repeated. See comments above

			a financial mitigation technique and it should therefore constitute the main point of focus.	
67	AVIVA	3.33	The application of the financial mitigation techniques needs “appropriate number of sufficiently qualified staff”. More guidance on this requirement would be helpful.	Agreed Clarification on knowledge and expertise included.
68	Pearl	Para 3.33	The application of the financial mitigation techniques needs “appropriate number of sufficiently qualified staff”. More guidance on this requirement would be helpful.	Agreed Repeated. See comment 67
69	DIMA	3.33	Recognising the requirements of 3.33 (in terms of the quantity of distinct resources and the appropriate expertise of those resources), it may be useful to establish whether or not the guidance includes the ability to rely on external parties in the application and implementation of the financial mitigation procedures.	Disagreed. There is a specific advice on outsourcing. No exception to such advice are consider necessary in CP31.
70	IE S2 Group	3.33	Recognising the requirements of 3.33 (in terms of the quantity of distinct resources and the appropriate expertise of those resources) it may be useful to establish whether or not the guidance includes the ability to rely on external parties in the application and implementation of the financial mitigation procedures.	Disagreed. Repeated. See comment 69
71	ABI	Para 3.33	The application of the financial mitigation techniques needs “appropriate number of sufficiently qualified staff”. We welcome more guidance on this requirement to understand better what is specifically implied in the context of financial mitigation techniques.	Agreed Repeated. See comment 67
72	CEA	Para 3.33, Para	More detailed guidance on what constitutes *“a sufficient number of*	Agreed

		3.45	*appropriately qualified staff"* (3.33) and *"sufficient legal review"* (3.45) would be helpful as would guidance on the application of proportionality in these assessments.	Repeated. See comment 67
73	ABI	Para 3.34	We believe that the conditions required by the Supervisor - and its time to give a response - in order to assess the eligibility of financial instruments to reduce the SCR through their properties of mitigation, should be more formalised and agreed consistently across the European Supervisors. That would avoid arbitrage and lack of clarity.	Agreed. This will be achieved as part of CEIOPS (or future ESA) role.
74	AVIVA	3.34	We believe that the conditions required by the Supervisor - and its time to give a response - in order to assess the eligibility of financial instruments to reduce the SCR through their properties of mitigation, should be more formalised and agreed consistently across the European Supervisors. That would avoid arbitrage and lack of clarity.	Repeated. See comment 73
75	Pearl	Para 3.35 / 3.36	To allow financial mitigation techniques to be included in the calculation of the SCR will we have to produce the SCR net and gross of financial mitigation techniques?	Yes in the modules where it is required (e.g. counterparty)
76	Oliver Wyman	Para 3.35 Para 3.36 Para 3.55	While we understand the need to separate out the risk mitigation impact from the acquired (counterparty) risks in order to maintain the structure of the standard formula approach, we are concerned that this may result in an overstatement of the net impact of risk mitigation due to correlation effects, i.e. where the risk of counterparty default increases along with the value of the mitigating instrument. This is not captured sufficiently in the SCR correlation matrix, which (for example) ascribes a correlation of 0.25 between counterparty default and market risk.	Noted. Paragraph 3.55 solves the problem

			While Paragraph 3.55 attempts to place a cap on this effect by disallowing mitigating instruments where this effect is "material", this is a blunt approach and is unlikely to capture the full impact. Instead we would advocate considering a bundled approach whereby the mitigating effect is reduced in a systematic way by the possible or probability-weighted impact of default at the 1-in-200 level, i.e. the 1-in-200 value of the mitigating instrument is reduced by the probability of default of the counterparty in those conditions.	
77	DIMA	3.35	The term "risk transfer" is not ideal as it is somewhat prejudiced in terms of its existing application to underwriting risk. Furthermore, this terminology may be interpreted as suggesting that there is a level of "indemnity" coverage in the mitigation techniques which is not necessarily the case (this is related to the overall comment as to distinctions between hedging, guaranteeing and mitigating above). We propose the deletion of the words "commensurate with the extent of risk transfer" as this is implicit in the requirement to take credit in the first instance.	Agreed. We understand this comment refers to the formal wording, although agreeing in the substance of paragraph 3.35 The wording will be revised
78	IE S2 Group	3.35	The term "risk transfer" is not ideal as it is somewhat prejudiced in terms of its existing application to underwriting risk. Furthermore this terminology may be interpreted as suggesting that there is a level of "indemnity" coverage in the mitigation techniques which is not necessarily the case (this is related to the overall comment as to distinctions between hedging, guaranteeing and mitigating above). We propose the deletion of the words "commensurate with the extent of risk transfer" as this is implicit in the requirement to take credit in the first instance.	Agreed. Repeated. See comment 77

79	Lloyd's	Para 3.38	There could be more clarity given on the definition of "…..enforceable in all relevant jurisdictions". We assume this to be all jurisdictions relevant to the transaction (rather than all jurisdictions relevant to the undertaking).	Agreed.
80	Deloitte	Para.3.39	We would welcome clarification as to what constitutes "appropriate assurance."	Noted It is a general statement.
81	DIMA	3.39	It may be useful to clarify who needs to receive "assurance" and furthermore to eliminate the reference to "risk transfer". The paragraph may benefit from being described in a more objective fashion such as: "The company must be able to demonstrate the effect of the financial mitigation technique on the SCR."	Agreed.
82	IE S2 Group	3.39	It may be useful to clarify who needs to receive "assurance" and furthermore to eliminate the reference to "risk transfer". The paragraph may benefit from being described in a more objective fashion such as "The company must be able to demonstrate the effect of the financial mitigation technique on the SCR."	Agreed. See comment above
83	DIMA	3.40	As per notes on 3.24/3.25, the terminology of 3.4 appears to have an expanded scope in its application in that roll over of instruments where the instruments are shorter than 1 year leads to a pro rata reduction in effectiveness as per QIS4 TS.IX.C.6.	Noted Treatment of roll over has been clarified
84	IE S2 Group	3.40	As per notes on 3.24/3.25 the terminology of 3.4 appears to have an expanded scope in its application in that roll over of instruments where the instruments are shorter than 1 year lead to a pro rata reduction in effectiveness as per QIS4 TS.IX.C.6.	Noted See above

85	Lloyd's	Para 3.40	Whilst Lloyd's agrees that allowance in the SCR is restricted to instruments (and not processes and controls of investment risk) it should not be seen to discourage sound practices in these areas. This could be highlighted in the advice.	Disagreed. Since this is a legal text, it seems not relevant to introduce such statement in the advice
86	FFSA	3.40	The CP says : *"The allowance for financial mitigation techniques in the standard formula SCR is restricted to instruments and excludes processes and controls the firm has in place to manage the investment risk. This does not preclude the allowance for future management actions in the calculation of technical provisions following the change in financial conditions, as contained in CEIOPS advice on future management actions"* The text is not clearly written, however based on (3.25) we understand that dynamic hedging is not considered as financial mitigation technique. It is key that dynamic or rolling hedging programs can be considered in the SCR calculation. If the dynamic hedging program is well documented and has proved its effectiveness then it should be considered as financial mitigation technique.	Disagreed. See above comments on dynamic hedging
87	CRO	Para 3.40	*"The allowance for financial mitigation techniques in the standard formula SCR is restricted to instruments and excludes processes and controls the firm has in place to manage the investment risk. This does not preclude the allowance for future management actions in the calculation of technical provisions following the change in financial conditions, as contained in CEIOPS advice on future management actions."* The wording is not clear whether or not future management action (i.e	Disagreed. Repetition. See comments above on dynamic hedging

			processes and control) to manage investment risk will be or not recognized (overlap between CP 31 and CP 32). If dynamic hedge programs are well documented and have proven there effectiveness, they should be considered as financial risk mitigation techniques. Dynamic or rolling hedging programs and other dynamic investment strategies, like cash-flow matching, should therefore be considered in the SCR calculation..	
88	GC	Para 3.40	Excluding processes and controls the firm has in place to manage investment risks does not seem reasonable. First of all, it will be difficult to distinguish processes and controls which are in place to manage investment risk from other processes and controls. Secondly, not allowing all processes and controls implies a deviation from an economic approach. Thirdly, it gives incentives to the insurer to use derivatives instead of for example CPPI's to reduce financial risks, although CPPIs could be more cost efficient in certain situations. For some risks financial instruments might not even be available and hence good processes and controls are the only available alternative and insurers should be given incentives to get these processes and controls in place. See also comment under 3.43. Due to the importance of financial risks for many insurers, both large and small, allowance should be possible without having to use internal models. This would also minimize the problem of having to distinguish between processes and controls in place for financial risk management purposes and other purposes.	Disagreed. See above comments on dynamic hedging
89	Unespa	Para 3.40	This section establishes that recognition of the risk mitigation	Disagreed.

			techniques in the standard SCR formula is restricted to "instruments" and excludes "processes and controls" which the insurance company has established in order to manage the investment risk. It is considered that this paragraph should in the first instance clarify that the cash-flow matching or delta-hedging techniques which many insurance companies are currently using reduce capital requirements instantaneously (section 3.25 clarifies this somewhat when it states: "the change in financial conditions should be treated as being an instantaneous shock"). In other words, the fact that they are not considered to be financial risk mitigation techniques on account of not being instruments, does not mean that the use of cash-flow matching and delta-hedging techniques does not serve to reduce capital requirements as an "instantaneous shock". Irrespective of this, consideration should be given to whether this restriction to "instruments" excluding all other types of processes and controls is excessively limiting. In effect, this limitation could exclude the financial risk mitigation effects of certain techniques or strategies (which are not "instruments" but which cannot be classified as "future management actions" either) which have demonstrated their usefulness and efficiency in the past in mitigating such risk.	See above comments on dynamic hedging
90	Munich Re	Para 3.40	Dynamic hedging should already be reflected in the standard formula approximately, e.g. with appropriately calibrated instantaneous shocks.	Disagreed. See above comments on dynamic hedging
91	CEA	Para 3.40	We believe that **dynamic or rolling hedging programs and other dynamic investment strategies, like cash-flow matching, should**	Disagreed. See above comments on dynamic

			be considered in the SCR calculation. If the hedging program is well documented and is expected to be effective then it should be considered as financial mitigation technique.	hedging
92	Pearl	Paras 3.41 to 3.58	We agree with the 5 principles set out by CEIOPS.	Noted Appreciated
93	P&I	3.41	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 of CP28.	This comment refers to issues out of the scope of CP31
94			Confidential comment deleted.	
95			Confidential comment deleted.	
96	Lloyd's	Paras 3.41-3.43	Lloyd's agrees with Principle 1: Economic effect over legal form.	Noted Appreciated
97	ABI	Paras 3.41 to 3.46	We agree with the 5 principles set out by CEIOPS. However, we believe care is needed on liquidity (principle 3) and credit (principle 4). They are not always relevant risks; they are not always appropriate to the risk type of the organisation.	Disagreed We still see appropriate the way principles 3 and 4 are written. More detail would be necessary

				to concrete this general comment
98	CEA	Para 3.41-3.46	We agree with the 5 principles set out by CEIOPS. However, we believe care is needed on judging liquidity (principle 3) and credit (principle 4). They are not always relevant risks in judging the effectiveness of the financial mitigation technique.	Disagreed Repeated. See comment 97
99	GC	Para 3.42	More details needed on the risks expected to be included in "material new risks", how these new risks should be measured and how the risks should be included within the SCR.	Agreed. It will be analyzed as part of the revision of CP31
100	AVIVA	Para 3.43	We find this requirement too onerous. In practice you cannot buy perfect hedges. A point is made about basis risk between the derivative and underlying assets. This raises the question whether an institution really needs to assign specific derivatives to specific assets in order to take the derivative into account when calculating the required capital. The alternative would be to regard the derivative as any other asset class, but with an opposite effect under stress. For instance, there could be material basis risk between an equity portfolio and a put option (notional equal to portfolio value) because the underlying assets do not exactly match the equity portfolio. However, the equity test would require applying a certain percentage market value loss, regardless of the exact composition of the equity portfolio. The equity put option will gain value under the test, completely mitigating the equity loss. Hence, the question is "Does the CP text suggest that derivative values under stress can only be taken into account in the calculation of the SCR if	Disagreed. See comment 18

			they are treated as Financial Mitigation Techniques?"	
101	CRO	Para 3.43	*"When the underlying assets or references of the financial mitigation instrument do not match perfectly the exposures of the undertaking, there shall be no allowance of the mitigation instrument in the calculation of the SCR unless the undertaking can demonstrate that the basis risk is not material compared to the mitigation effect. If allowance of the financial mitigation technique in the calculation of the SCR is made, the calculation should account for the basis risk in line with the 99.5% confidence level of the SCR."* When there is material basis risk between the exposure and the mitigation instrument then basis risk should be taken into account in the SCR. The question is when basis risk is "material". More guidance is needed. This potentially impact a lot how we can account for hedging strategies in both the internal model and the standard formula. A proportional approach should also be allowed, rather than a yes / no recognition related to the demonstration of whether basis risk is or isn't "material". We suggest that risk mitigation techniques are recognized in a way that reflects the extent of basis risk.	Agreed. This paragraph requires clarification quires clarification Disagreed. See comment 18
102	Lloyd's	Para 3.43	There is a danger the interpretation of "matching perfectly" could be too strong. We would suggest replacing with "matching effectively". Either way, the terms "perfectly" or "effectively" needs to be defined in some way. We would also request further guidance on possible (or expected)	Agreed. This paragraph requires clarification Disagreed.

			calculations underlying any basis risk that is introduced in the process and therefore needs to be included within the standard formula SCR.	See comment 18
103	FFSA	General comment	We generally agree with the 5 principles for recognising financial mitigation techniques Agreement with 3.58 3.59 3.62. (3.57.) could be stated more precisely. What are 'generally applied procedures', what are 'generally admitted criteria'? Agreement with 3.32 3.33	Noted. Appreciated
104	DIMA	3.42/3.43	Whereas the principle of setting the capital for new risks and basis risks is accepted, measuring residual risks with precision may be somewhat hampered in practice. Overall limitations on hedge effectiveness may perhaps be best addressed through a more formalized and crude haircut where the matching is not complete; this is consistent with limitations under AG 43 in the US in respect of hedge effectiveness credits when setting reductions in conditional tail expectations.	See comments above
105	IE S2 Group	3.42/3.43	Whereas the principle of setting the capital for new risks and basis risks is accepted the practice of measuring residual risks with precision may be somewhat hampered in practice. Overall limitations on hedge effectiveness may perhaps be best addressed through a more formalized and crude haircut where the matching is not complete, this is consistent with limitations under AG 43 in the US in respect of hedge effectiveness credits when setting reductions in conditional tail expectations.	Repetition. See comments above
106	Pearl	Para 3.43	What does “perfectly matched” and the “basis risk is not material”	Agreed. This paragraph requires

			actual mean? Professional guidance on what is required for something to be classified as "perfectly matched" would be helpful. Material should be defined in line with the International Accounting Standards Board's Framework for the Preparation and Presentation of Financial Statements: "Information is material if its omission or misstatement could influence the economic decision of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful."	clarification
107	FFSA	3.43	The CP says : "*"When the underlying assets or references of the financial mitigation instrument do not match perfectly the exposures of the undertaking, there shall be no allowance of the mitigation instrument in the calculation of the SCR unless the undertaking can demonstrate that the basis risk is not material compared to the mitigation effect. If allowance of the financial mitigation technique in the calculation of the SCR is made, the calculation should account for the basis risk in line with the 99.5% confidence level of the SCR."* We believe that financial mitigation techniques that do not perfectly match the exposure of the undertaking should be recognized partially. We suggest changing the text into: *"When the underlying assets or references of the financial mitigation instrument do not match perfectly the exposures of the undertaking, there shall be allowance of their mitigation effect in the SCR calculation for the part of the exposure hedged.*	Disagreed. See comment 18

108	IUAL	Para 3.43	This paragraph refers to "instruments which do not match perfectly the exposures of the undertaking". We would suggest that a perfect match, depending on how it is defined, might not always be possible to find; therefore the scope of permitted instruments could be quite narrow. Potentially a wide range of instruments might need to be "demonstrated that the basis risk is not material to the mitigation effect" according to this principle. This could be onerous. With regards to the needs to demonstrate that basis risk is not material to its risk mitigation effect, we would query whether any diversification benefit might be considered where a variety of different financial mitigation techniques are used. Potentially if mitigation techniques are spread over different instruments the degree of basis risk for any given instrument will be reduced at the level of the SCR, providing of course that those instruments still matching the risk exposures of the undertaking.	Disagreed. See comment 18
109	Deloitte	Para.3.43	We consider that the requirement that the bases "match perfectly" could be unduly prohibitive, and may effectively disallow nearly all risk mitigation techniques. In addition, we would welcome clarification in respect of the requirement to match perfectly "unless basis risk is not material". The requirement goes on to indicate that the calculation should account for basis risk, irrespective of whether it matches perfectly or is not material. While we believe that it is appropriate for basis risk to be considered as part of the calculation, there appears to be some inconsistency in the guidance which may lead to varied interpretations.	Disagreed. See comment 18 Nevertheless basis risk should be clarified

110	GC	Para 3.43	The basis risks will in many cases include policyholder characteristics, such as actual mortality rates, and policyholder behaviour. Transfers and surrender are often major risks and it is unclear how and to what extent these should be included in the basis risk or not. Many financial instruments are very sensitive to parameters which are subjectively set or based on limited amount of data. Especially, the uncertainty in the parameter estimates can be very large. Therefore, prudent basis risk estimation at 99,5 % confidence level would show that many financial instrument are very inefficient in reducing risks. Cross-industry harmonisation on how parameter uncertainty should be considered is therefore very important.	Noted.
111	Unespa	Para 3.43	This section establishes that when the assets or references underlying the financial mitigation instrument do not permit "perfect" matching of the risks covered by the insurance company, then no reduction in the capital requirements associated with the risk mitigation techniques will be permitted, unless it can be demonstrated that "the basis risk is not material" compared to the mitigation effect. It is considered that this section is not in accordance with the economic approach in the Directive and its drafting should therefore be amended, as, in practice, in many cases, there are no financial instruments which enable "perfect" matching of the risks covered by the insurance company. In the event that the matching is not perfect, there should still be a partial reduction in capital requirements. Once again we are in an all-or-nothing position (reduce by the full amount or do not reduce at all) which is not supported by the level 1 regulation.	Disagreed. See comment 18

			Furthermore, there should be more detailed clarification of the meaning of "basis risk" and "is not material", as these concepts could lead to confusion. In addition to clarifying the concept of "basis risk" in more detail, it would perhaps also be useful to make the following drafting change: "Unless the undertaking can demonstrate that the basis risk is smaller than the mitigation effect".	Agreed. Clarification has been included
112	ABI	Para 3.43	'When the underlying assets or references of the financial mitigation instrument do not match perfectly the exposures of the undertaking, there shall be no allowance of the mitigation instrument in the calculation of the SCR unless the undertaking can demonstrate that the basis risk is not material compared to the mitigation effect'. Insurers will not necessarily be experts in market risk and they need to understand the derivative exposure. Some high level guidance is therefore needed in Level 2 on many of the industry standard mitigants, e.g. CDS and equity hedges. Whilst we agree with CEIOPS that techniques should be allowed if the basis risk (underlying of technique doesn't not match perfectly the exposure of the undertaking) is immaterial, we believe that defining effective matching might be more relevant than 'perfect matching' as this should prove very hard to attain. The concept of materiality would also need further guidance in view of the latest market volatility. In addition, we note that the basis risk will need to be included in the SCR but it is not clear how this would fit within the structure of the standard model.	Agreed. Clarification has been included

			A point is made about basis risk between the derivative and underlying assets. This raises the question whether an institution really needs to assign specific derivatives to specific assets in order to take the derivative into account when calculating the required capital. The alternative would be to regard the derivative as any other asset class, but with an opposite effect under stress. For instance, there could be material basis risk between an equity portfolio and a put option (notional equal to portfolio value) because the underlying assets do not exactly match the equity portfolio. However, the equity test would require applying a certain percentage market value loss, regardless of the exact composition of the equity portfolio. The equity put option will gain value under the test, completely mitigating the equity loss. Hence, the question is "Does the CP text suggest that derivative values under stress can only be taken into account in the calculation of the SCR if they are treated as Financial Mitigation Techniques?" With regards to the needs to demonstrate that basis risk is not material to its risk mitigation effect, we would query whether any diversification benefit might be considered where a variety of different financial mitigation techniques are used. Potentially if mitigation techniques are spread over different instruments the degree of basis risk for any given instrument will be reduced at the level of the SCR, providing of course that those instruments still matching the risk exposures of the undertaking.	Disagreed. See comment 18 This advice shall be applicable both to the 'financial mitigation techniques' considered as such by the undertaking and also to those others with the same or similar economic effects, even if they have not been qualified as 'financial mitigation techniques'.
113	Munich Re	Para 3.43	"Not material" should be further defined. In general risk mitigation should be considered according to its	Agreed. Disagreed.

			economic effect, including allowance for basis risk.	See comment 18
114	Oliver Wyman	Para 3.43	It is inevitable that many of the financial mitigating techniques will involve some basis risk, and we agree that this should be recognised within the SCR calculation. However we would note that the level of granularity at which the standard formula is applied is likely to be such that a detailed assessment of basis risk may be spurious and we would urge proportionality in this regard.	Disagreed. See comment 18
115	AMICE	Para 3.43	In our opinion more flexibility is needed for assessing financial mitigation techniques such as non-proportional reinsurance to ensure that reinsurance is adequately considered in the SCR calculation in a 200-year event. Proportional and non-proportional reinsurance treaties can be adequately considered by using partial or full internal models. This should not prevent undertakings which calculate their capital requirements using the standard formula to obtain adequate capital relief for either a proportional or non-proportional solution. We miss in this CP more guidance on how to take account of partial mitigation techniques and on alternative approaches when financial mitigation instruments are not available. This is a key issue for our small and medium-size membership.	Out of the scope this CP

116	CEA	Para 3.43	There is a requirement for the basis risk under a financial mitigation technique not to be material compared to the mitigation effect. We believe that such a requirement is not aligned with an economic view of financial mitigation techniques and we recommend CEIOPS to recognize the existence of capital reduction for all cases and not only when basis risk is immaterial.	Disagreed. See comment 18
117	CEA	Para 3.43	Allowance for basis risk within the SCR is required, but no guidance is given on how this is to be achieved. This could be seen as requiring the use of unapproved internal models and is also inconsistent with the treatment of unhedged risks in the standard formula SCR (where, for example, differences between actual equity portfolios held and the indices used to derive the equity shock are ignored). More guidance is required on quantifying *"basis risk".*	Disagreed. See comment 18
118	Lloyd's	Paras 3.44-3.47	Lloyd's agrees with Principle 2: Legal certainty, effectiveness and enforceability.	Noted. Appreciated
119	Lloyd's	Para 3.44	The reference to "insurance undertaking" should be changed to "undertaking" as the principle applies to reinsurance undertakings as well.	Agreed.
120	CRO	Para 3.44 & 3.46t	*"The financial mitigation instruments used to provide the risk mitigation together with the action and steps taken and procedures and policies implemented by the insurance undertaking shall be such as to result in risk mitigation arrangements which are legally effective and enforceable in all relevant jurisdictions."*	See comments on paragraph 3.40

			"In case the full effectiveness or ongoing enforceability cannot be verified, the financial mitigation technique shall not be recognised in the SCR calculation." The requirement (3.44 and 3.46) of a perfect match of the instrument with the exposure of the firm seems rather restrictive. A system of partial mitigation could be investigated in case of a non-perfect match. Indeed, to be consistent with Solvency II principles, any financial assets should be taken into account whatever their objective is (risk mitigation assets, traditional financial assets) In case of mitigating the risk of stock investments the proposed requirement forces companies to invest in line with indices for which hedges are available. This increases the systemic risk for the financial industry.	Disagreed. See comment 18
121	AVIVA	Para 3.45	More guidance would be needed on how to interpret a "sufficient legal review".	Noted.
122	Pearl	Para 3.45	More guidance would be needed on how to interpret a "sufficient legal review".	Noted.
123	ABI	Para 3.45	We believe a "sufficient legal review" would not be needed for standard contracts.	Disagreed Even a standard contract might include a clause which deactivates the effectiveness or enforceability under certain

				circumstances
124	CEA	Para 3.45	A *"sufficient legal review"* may not be needed for standard contracts.	Disagreed Repetition. See comments above
125	Deloitte	Para.3.46	The effectiveness of the enforceability of the financial mitigation technique will often be based on the default risk inherent in the counterparty to any applicable financial instrument. While we do not believe the spirit of the guidance would result in a restriction to the mitigation, we believe that it would be helpful to further clarify the applicability of counterparty default risk to the assessment of enforceability.	Disagreed The effectiveness and the enforceability required here try to avoid the cases where the counterparties don't pay, but different from the default cases (e.g. based on disclaimer clauses)
126	Munich Re	Para 3.46	"Verification" in a strict interpretation might only be done for the past and is therefore misleading. The recognition of financial mitigation techniques should be based upon up-to-date and credible information and realistic assumptions. Especially the recognition of financial mitigation techniques in future management actions should take into account the "going concern"-principle. The measurement of effectiveness should account for the asymmetry of hedging activities. We suggest the following rewording: "Recognition of financial mitigation in the SCR calculation shall be granted, if full effectiveness or ongoing enforceability can be assumed based upon up-to-date and credible information and realistic assumptions in line with the principle of "going concern"."	Disagreed Verification here means to ensure that the terms and conditions of the financial mitigation instrument actually fulfil all the requirements above and this can be done at the valuation date. Off course the final effectiveness and enforceability only can be verified after the mitigation of the loss is required.

127	AVIVA	3.47	Additional guidance is needed on documentation requirements	Agreed. Some guidance on documentation included
128	Lloyd's	Para 3.47	Some guidance on "deficiently" would help to add clarity.	Agreed.
129	IUAL	Para 3.32 Para 3.47	We note the comment about insufficiently documented financial mitigation techniques resulting in now allowance within the SCR. We believe that further guidance at Level 3 might be necessary, particularly with regards to the degree of proportionality for techniques which have different degrees of materiality and complexity. A principles based approach to documentation might help identify the types of information required, with further guidance on how proportionality might be applied.	Agreed. Some guidance on documentation included
130	ABI	Para 3.47	Additional guidance is needed on documentation requirements. A principles based approach to documentation might help identify the types of information required, with further guidance on how proportionality might be applied.	Agreed. Some guidance on documentation included
131	AVIVA	3.48-3.51	We strongly agree with these requirements	Noted Appreciated
132	Lloyd's	Paras 3.48-3.52	Lloyd's agrees with Principle 3: Liquidity and ascertainability of value.	Noted

				Appreciated
133	Oliver Wyman	Para 3.48	The definition of "value" should be specified in more detail, as (re)insurance undertakings may assume different interpretations, e.g.: a) a market-consistent value implied by a deep and liquid market b) a price quoted by a broker, counterparty or external valuation provider in a market which is not deep and liquid c) a value implied by an internal model In our view, the value specified should be the market-consistent value implied by a deep and liquid market. In addition, while we believe that the requirement of reliable value is broadly correct, there is one exception: static hedging techniques where the underlying instruments will be held to maturity do not require a reliable value in excess of the reliability of the value of the underlying liability (e.g. reinsurance of financial risks through external reinsurers or securitisation or static hedging of long-term cash-flows through customised derivatives). For the avoidance of doubt this exception should be included in the guidance provided.	Agreed. This shall be amended
134	AMICE	Para 3.48-Para 3.49	Some discussions held within the banking sector and in particular as to Basel II amendments, lead to the conclusion that banks' exposures to market risk and credit risk vary with the liquidity conditions in the market; liquidity conditions in turn are also determined by perceptions of market and credit risk. For this reason, AMICE suggests including in this advice some	Agreed. A revision in this sense will be carried out

			statements on the importance of establishing liquidity risk tolerance limits and the methods for the identification and measurement of the full range of liquidity risks	
135	Lloyd's	Para 3.49	The phrase "…according to the objectives of the own undertaking's risk management policy" could be altered to "…according to the objectives of the undertaking's risk management policy". Also the phrase "….to meet the liquidity requirements established by the own entity" could be altered to "…to meet the liquidity requirements established by the undertaking".	Agreed. A revision in this sense will be carried out
136	CRO	Para 3.49	*"Regarding the liquidity of the financial mitigation technique, the following two general statements shall apply:* *• The undertaking should have written internal policy regarding liquidity requirements that financial mitigation techniques should meet, according to the objectives of the own undertaking's risk management policy;* *• Financial mitigation techniques considered to reduce the SCR have to meet the liquidity requirements established by the own entity."* This point requires internal policies regarding liquidity requirements that financial mitigation techniques should meet. While it makes sense in general to look at liquidity of mitigation strategies, we suggest that this should not be viewed in isolation, and more in the general in the context of overall balance sheet liquidity management	Agreed. A revision in this sense will be carried out
137	ABI	Para 3.49	Undertakings having appropriate internal policies on liquidity at entity level should not be obliged to monitor liquidity at instrument level.	
138	Munich Re	Para 3.49	Liquidity should be monitored at the level the risk is managed which	Agreed. A revision in this sense

			would not be the instrument level.	will be carried out
139	CEA	Para 3.49	Undertakings having appropriate internal policies on liquidity at entity level should not be obliged to monitor liquidity at instrument level.	Agreed. A revision in this sense will be carried out
140	Deloitte	Para.3.51 and Para.3.52	Our interpretation of these paragraphs is that were the risk to reduce, the SCR would not decrease, but if the risk were to increase, then so should the SCR. This would appear to be restrictive, and we believe that the SCR should increase or decrease as the calculation requires.	Agreed. Clearer paragraph should be introduced
141	FFSA	3.51	We do not understand the paragraph. Could the CEIOPS give more explanation?	Agreed. Clearer paragraph should be introduced
142	GC	Para 3.51	How should one show that the financial risk mitigation technique reduce risk? What are the requirements on the model to be used?	Agreed. Clearer paragraph should be introduced
143	ABI	Paras 3.51, 3.52	Those paragraphs state that the SCR should not increase if financial risk mitigation techniques reduce risk and the SCR should increase if financial risk mitigation increases risks. Typically financial risk mitigation will reduce market risk but increase counterparty risk. Hence the phrase 'reducing risk' could be ambiguous. The intention of this advice appears to be to stop companies exploiting (or being adversely affected by) weaknesses in the standard formula. This should be picked up by pillar 2. It would be better to provide more general advice that a supervisor may not allow credit taken for company actions that reduce SCR, if they are unable to justify that the actions reduce the overall level of risk of not being able to meet the liabilities to policyholders.	Agreed. Clearer paragraph should be introduced
144	CEA	Para 3.51	We have found this paragraph difficult to understand. Can this be	Agreed. Clearer paragraph should

			clarified?	be introduced
145	DIMA	3.53-3.54	It may be useful to clarify whether the requirement of BBB is independent of the collateral mechanism being employed or is considered to be the effective rating of the exposure post collateralisation/credit risk mitigation.	Noted The financial protection provider and the collateral mechanism should be considered.
146	IE S2 Group	3.53-3.54	It may be useful to clarify whether the requirement of BBB is independent of the collateral mechanism being employed or is considered to be the effective rating of the exposure post collateralisation/credit risk mitigation.	Noted The financial protection provider and the collateral mechanism should be considered..
147	Lloyd’s	Paras 3.53-3.55	Lloyd’s agrees with Principle 4: Credit quality of the provider of the financial mitigation instrument.	Noted Appreciated
148	ABI	Paras 3.53 to 3.55	**Principle 4: Credit quality of the provider of the financial mitigation instrument** ‘…the financial mitigation instrument should be capable of liquidation in a timely manner or retention’. We believe this needs to be applied sensibly and proportionately as a rigorous application of this requirement could have unintended and counterproductive pro-cyclical effects. In terms of the application of Basle 2 (CP 28), the standardized Basle 2 rules looked in some detail at the probability distributions behind the counterparty default parameters for ratings and LGD. The level of work they put into these issues would mean that it would be useful for	Noted

			CEIOPS to look at this work as a basis for their work on parameterising the current formulations for counterparty default risk. Furthermore, any differences between the banking requirements and the insurance requirements would allow for arbitrage opportunities if these do not reflect real differences in the instruments.	
149	CEA	Para 3.53-3.55	*'…the financial mitigation instrument should be capable of liquidation in a timely manner or retention'.* We believe this needs to be applied sensibly and proportionately as a rigorous application of this requirement could have unintended and counterproductive pro-cyclical effects.	Noted
150	Lloyd's	Para 3.54	We would like to see some further clarity on the treatment of issuers rated below BBB, especially where it involves collateral. For example, a fully collateralised transaction involving an unrated issuer should be allowed for in the SCR calculations but would not be as currently worded.	Noted The wording shall be amended accordingly to clarify this case See comment 6
151	AVIVA	3.54	We believe the requirement in the event of default, insolvency or bankruptcy is too stringent. It is not going to be possible to comply with it in most of the cases unless there is a collateral associated with the financial mitigation instrument. They way it should be covered is by allowing the credit risk on the calculation of the SCR via the counterparty default risk module.	Disagreed Cross-sector requirement (see Basel accord II, part 2, paragraph 123).
152	FFSA	3.54	The CP says : *"As a general rule, when the undertaking applies the standard calculation for a certain risk module, only financial protection provided by entities rated BBB or better shall be allowed in the assessment of SCR. In the event of default, insolvency or bankruptcy of*	Disagreed

			the provider of the financial mitigation instrument – or other credit events set out in the transaction document – the financial mitigation instrument should be capable of liquidation in a timely manner or retention." Even if we do not think any insurer would buy any derivative with institutes that are rated lower than BBB, there should be no restriction on assets eligibility (as we mentioned in the general comments). Risk mitigation should in all cases be recognised for its economic value, whatever the rating of the counterparty.In particular, if an insurer sees the credit rating of one of its risks mitigating contracts downgraded, the remaining risk mitigating effect of the contract should still be recognised. The counterparty risk module that calculates the default risk of risk mitigating contracts already heavily penalizes the low ratings. We believe this is already a sufficient penalisation.	See comment 4
153	IUAL	Para 3.54	We note that this is a general rule, although we would welcome examples on where this general rule might not apply. For example, if an issuer of a financial mitigation instrument has a credit rating of less than BBB rated, but that instrument is backed by a collateral provision (or some other form of security or guarantee), then would it be permissible to include that instrument in the assessment of the SCR at all? We also have some reservations on the reliance upon credit ratings, although accept these might be a useful reference point when assessing credit quality of an issuer.	Noted. Clarifications on the example and rating BBB+/BBB/BBB- will be included.

			Whilst we recognise the BBB limit for the recognition of financial protection, we do note that some credit rating agencies will offer a credit rating with a plus or minus suffix (e.g. BBB+ or BBB-). For the avoidance of doubt, we think it might be useful to clarify whether BBB or BBB- is the rating limit for financial recognition to be permitted.	
154	Deloitte	Para.3.54	We believe that the 'BBB or better' requirement could be overly restrictive. If the counterparty risk is allowed, then all mitigating actions should be reflected in the SCR. Specifically, we are concerned that this limitation may adversely impact the valuation of certain unrated or internal transactions.	Disagreed See comment 4
155	CRO	Para 3.54	*"As a general rule, when the undertaking applies the standard calculation for a certain risk module, only financial protection provided by entities rated BBB or better shall be allowed in the assessment of SCR."* The CRO-Forum recommends the use of counterparties with sufficient financial health; however this does not depend on whether or not this counterparty is rated by a rating agency. The use of financial protection provided by unrated, financially-healthy counterparties should therefore be recommended as well. In addition, it is common to have collateral requirements for market exposure in financial (or even non-financial) risk mitigation instruments with counterparties. We see no reason to introduce a "ratings rule" for mitigation strategies where the counterparty credit risk is managed. The offset of collateral pledged and other counterparty credit mitigation techniques should form an	Noted. See comment 153

			offset to the counterparty credit exposure	
156	GC	Para 3.54	How is “in a timely manner” defined?	Noted. As in Basel accord II
157	Unespa	Para 3.54	It would certainly seem to be a paradox that a minimum credit rating of BBB is required for the financial mitigation effect to be recognised whilst, at the same time, the capital load applicable to all types of credit exposure is established in the counterparty risk module, even when the instruments involved have credit quality which is lower than BBB. In addition, an instrument may have its credit rating temporarily reduced below BBB without this necessarily meaning that it has lost its associated risk mitigation effect, as the increased counterparty risk is already being captured by the establishment in the counterparty risk module. Therefore, the BBB minimum credit rating requirement should be removed or, if this limit is not removed, a period of time should be established during which the risk mitigation effect would not be lost due to a temporary reduction in the credit rating of the instrument.	Disagreed This is not considered relevant. Banking practice at this respect not allows these proposals
158	ABI	Para 3.54	Implementing this requirement would prove very difficult since it is almost impossible to know in advance whether a financial risk instrument could be liquidated in a timely manner if the provider defaulted, became insolvent, or bankrupt. Normally in this scenario the instrument would not be liquid and furthermore would not have any value. So this advice would appear to rule out taking credit for financial	Disagreed Cross-sector requirement (see Basel accord II, part 2, paragraph 123).

			risk mitigation techniques, which is surely not the intention. Capital is already held for the event that the provider defaults under the 1 in 200 year market stress that has the maximum impact, and 3.54 appears to be unnecessary. We note that this is a general rule, although we would welcome examples on where this general rule might not apply. For example, if an issuer of a financial mitigation instrument has a credit rating of less than BBB rated, but that instrument is backed by a collateral provision (or some other form of security or guarantee), then would it be permissible to include that instrument in the assessment of the SCR at all? We also have some reservations on the reliance upon credit ratings, although accept these might be a useful reference point when assessing credit quality of an issuer. Whilst we recognise the BBB limit for the recognition of financial protection, we do note that some credit rating agencies will offer a credit rating with a plus or minus suffix (e.g. BBB+ or BBB-). For the avoidance of doubt we think it might be useful to clarify whether BBB or BBB- is the rating limit for financial recognition to be permitted.	Repetition. See comment 154
159	AMICE	Para 3.54	In line with some of the arguments stated in CEIOPS' paper "Lessons learned from the crisis", we would suggest adding a paragraph indicating what happens if a derivative is downgraded.	Agreed. It will be included.
160	CEA	Para 3.54	While the CEA agrees that only highly rated counterparties should be used for risk mitigation, we expect that the risk of default (along with an allowance for collateralisation) would be included in the counterparty default module rather than being a restriction on assets. In addition,	Disagreed See comment 4. Requiring a minimum credit

			for the case of downgrades, there may be provisions for the contingency of such downgrading.	quality is cross-sector consistent. Contingency provisions do not provide 99.5 confidence level
161	AVIVA	Para 3.55	We find this requirement not reasonable since it implies that CDS or equity hedges can not be used as a financial mitigation instrument.	Disagreed Cross-sector requirement (see Basel accord II, part 2, paragraph 124).
162	Lloyd's	Para 3.55	It might be clearer if this paragraph were rewritten as follows: "The correlation between the values of the instruments relied upon for risk mitigation and the credit quality of their provider shall not be unduly adverse (known in the banking sector as 'wrong way risk')".	Disagreed CP31 worded as in Basel accord. Nevertheless some clarification might be included
163	DIMA	3.55	Wrong way risk would appear to be hard to avoid where the risk mitigation is with the financial sector.	Disagreed Cross-sector requirement (see Basel accord II, part 2, paragraph 124).
164	IE S2 Group	3.55	Wrong way risk would appear to be hard to avoid where the risk mitigation is with the financial sector.	Disagreed Cross-sector requirement (see Basel accord II, part 2, paragraph 124).
165	FFSA	3.55	The CP says : *"The degree of correlation between the value of the instruments relied upon for risk mitigation and the credit quality of their provider shall not be undue, i.e. it should not be materially positive (known in banking sector as 'wrong way risk')."*	Disagreed Cross-sector requirement (see Basel accord II, part 2,

			Could the CEIOPS explain what it has in mind ?	paragraph 124). Nevertheless some clarification might be included
166	Unespa	Para 3.55	We consider that this paragraph should be removed as it imposes a significant and unnecessary restriction. The terms used are not clearly defined (“materially positive degree of correlation between the value of the instruments relied upon for risk mitigation and the credit quality of their provider”) and this could lead to confusion. If this restriction had been applied during the current financial crisis, the financial risk mitigation effects of the majority of instruments used by insurance companies would have had to be excluded; it would also be very difficult to evaluate to what extent a correlation might be materially positive.	Disagreed Cross-sector requirement (see Basel accord II, part 2, paragraph 124).
167	ABI	Para 3.55	It is impractical to require insurers to determine the correlation between the value of the financial mitigation instruments and the credit quality of their provider. Furthermore, if credit default swap spreads are to be taken as a proxy for the credit quality of the provider, then events of the last 12 months are likely to mean that few financial mitigants can demonstrate no material positive correlation and so few instruments would pass this test. Furthermore, we find this requirement not reasonable since it implies that CDS or equity hedges cannot be used as a financial mitigation instrument.	Disagreed Cross-sector requirement (see Basel accord II, part 2, paragraph 124).
168	AMICE	Para 3.55	In its advice, CEIOPS makes the statement that “(t)he degree of	Disagreed

			correlation between the value of the instruments relied upon for risk mitigation and the credit quality of their provider shall not be undue, i.e. it should not be materially positive (known in banking sector as 'wrong way risk')." We fail to fully understand what CEIOPS wants to say and believe that it is difficult to assess how "materially positive" a correlation can be; We think it is absolutely necessary that CEIOPS provides more guidance on this subject.	Cross-sector requirement (see Basel accord II, part 2, paragraph 124). Nevertheless some clarification might be included
169	CEA	Para 3.55	It is impractical to require insurers to determine the correlation between the value of the financial mitigation instruments and the credit quality of their provider. Furthermore, if credit default swap spreads are to be taken as a proxy for the credit quality of the provider, then events of the last 12 months are likely to mean that few financial mitigants can demonstrate no material positive correlation and so few instruments would pass this test. Could CEIOPS give more inputs on this correlation?	Disagreed Cross-sector requirement (see Basel accord II, part 2, paragraph 124).
170	AVIVA	Para 3.56 Point 3	We find this requirement is too demanding. It prohibits the use of financial mitigation techniques of renewable contracts or financial mitigation techniques where the renewal rate is related to the performance of the underlying risk.	See comment 175
171	ABI	Para 3.56 Point 3	We find this requirement is too demanding. It prohibits the use of financial mitigation techniques of renewable contracts or financial mitigation techniques where the renewal rate is related to the performance of the underlying risk.	See comment 175
172	Lloyd's	Para 3.56	Lloyd's agrees with Principle 5: Direct, explicit, irrevocable and	Noted

			unconditional features.	Appreciated
173	DIMA	3.56	In respect of the third bullet point, in particular in respect of clauses that would " ….increase the effective cost of protection as a result of certain developments in the hedged exposure", it is perhaps worth noting that this does not negate the cover but alter the value of the cover, so it may be better considered under the requirements of 3.50 to 3.52	Noted At the right level of prices the protection should be irrevocable. See comment 175
174	IE S2 Group	3.56	In respect of the third bullet point, in particular in respect of clauses that would " ….increase the effective cost of protection as a result of certain developments in the hedged exposure" it is perhaps worth noting that this does not negate the cover but alter the value of the cover as such it is perhaps better considered under the requirements of 3.50 to 3.52	Noted At the right level of prices the protection should be irrevocable. See comment 175
175	Unespa	Para 3.56	Principle 5 (3.56) establishes a requirement for an irrevocable feature and an unconditional feature. In this context, it should be stated that risk mitigation techniques can only reduce capital requirements if they are not subject to any clause where compliance is outside the direct control of the undertaking, in such a way that it permits to the protection provider (the counterparty) to cancel the cover unilaterally, or to increase the effective cost of the protection as a result of certain changes in the risk covered. In relation to these requirements, it should be stated that the mere existence of "break clauses" in an instrument should not give rise to exclusion of the risk mitigation effects of said instrument. If the causes which could lead to the "break clause" being executed are not under	Disagreed The reduction of the SCR needs to be based on solid foundations, not on the own undertaking's expectancies. What we have here is the possibility to substitute the effectiveness to cover losses with capital requirements by an instrument that should be

			the control of either of the parties (the insurance company or the counterparty), in other words, this is based on observable market data and is executed automatically by both parties, then the clause will continue to be beneficial for both parties and an effective risk mitigation technique. Furthermore, even in the case that the protection provider (the counterparty) could unilaterally cancel the cover under a cause stipulated in the contract, this should not automatically result in the exclusion of the risk mitigation effects associated with the instrument. In effect, once again we find ourselves in one of the all-or-nothing positions (reduce by the full amount or not at all) which are not supported by the Directive. Even in the event that the protection provider (the counterparty) could unilaterally cancel the cover based on a stipulation in the contract, the financial risk mitigation effects of the instrument should still be permitted, adjusted by the probability at all times that the "break clause" might be executed. For example, if an "asset swap" contract includes a "break clause" which would become unilaterally executable by the counterparty in the event of bankruptcy or insolvency of the insurance company, and the insurance company has an AA credit rating, then the probability of the "break clause" being executed should be considered to be very low, and it should therefore be possible to recognise the financial risk mitigation effects associated with the asset swap.	equivalent in such a goal, for that reason the irrevocability and unconditionality of both attending losses should be at the same level.
176	Munich Re	Para 3.56	The "direct claim" requirement shall not prevent transformer structures where an operational reinsurer stays in between the Special Purpose	Noted

			Vehicle and the ceding insurer. In a long term risk mitigation ongoing transactions costs (as service providers' fees) usually increase over time. This increase in transaction costs should not be affected by the clause (3rd bullet point).	At the right level of prices the protection should be irrevocable. See comment 175
177	CEA	Para 3.56	In relation to the requirements of *"irrevocable feature"* and *"unconditional feature",* the existence of *"break clauses"* shouldn't give rise to the exclusion of the risk mitigating effect if such clauses are not under control of either of the parties (for example the break clause is based on observable market data and is executed automatically by both parties).	Disagreed In the example, what happen after the market data is observed? Should the protection disappear because of the break clause, the mitigation effect disappear.
178	Unespa	Para 3.57	Clarification should be given of exactly what is meant in this context by "generally applied procedures" and "generally admitted criteria".	Noted
179	CEA	Para 3.57	The definitions of *"generally applied procedures"* and *"generally admitted criteria"* need to be included.	Noted
180	CRO	Para 3.58,	The comment made in response to paragraph 3.43 – in particular about avoiding a yes / no recognition related to the demonstration is also relevant to credit default swaps. 3rd bullet "In order for a credit derivative contract to be recognised, the credit events specified by the contracting parties must at least cover:	

			[…] • restructuring of the underlying obligation, involving forgiveness or postponement of principal, interest or fees that results in a credit loss event. Definition of 'restructuring' will be considered according to generally standardised clauses and the own undertaking's guidance, according to its risk management policy." "Restructuring of the underlying obligation" is identified as one of the credit events that must be covered. However, we note that as of March 2009 new US credit default swap contracts do not include restructuring as a credit event. So this requirement as it stands will exclude recognition of all new US CDS contracts.	Agreed. A revision in this sense will be carried out
181	Munich Re	Para 3.58	If in the future standardized credit derivatives are introduced, the list of credit events has to be updated to the standard definition of credit events.	Agreed. A revision in this sense will be carried out
182	P&I	3.59	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 –*	Noted.

			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 (set out in CP28), 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 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.	
183	CRO	Para 3.61	The advice should clarify that the consideration of prompt selling is not an absolute test of ability to always be able to sell the collateral regardless of market conditions. This issue should be assessed within general liquidity requirements rather than as part of a hard collateral test. "Undertakings must have clear and robust procedures for the timely liquidation of collateral to ensure that any legal conditions required for declaring the default of the counterparty and liquidating the collateral	Agreed. A revision in this sense will be carried out

			promptly are observed.	
184	Deloitte	Para.3.62	We would welcome clarification as to what criteria would need to be met for something to become "impossible according to market conditions".	Noted. When there're no available collateralized transactions with these characteristics in the market. See comment 180
185	Munich Re	Para 3.62	The wording should ensure that the definition of credit events for collateral is consistent with current and future standard agreements for collateralisation.	Agreed. A revision in this sense will be carried out