

**Comments Template on
Consultation Paper on EIOPA's second set of advice to the European
Commission on specific items in the Solvency II Delegated Regulation**

**Deadline
5 January 2018
23:59 CET**

Name of Company:	Oliver Lockwood FIA (Personal)	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ Do not change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇒ Leave the last column <u>empty</u>. ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph or a cell, keep the row <u>empty</u>. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. <p>Please send the completed template, <u>in Word Format</u>, to CP-17-006@eiopa.europa.eu</p> <p>Our IT tool does not allow processing of any other formats.</p> <p><u>The numbering of the reference refers to the sections</u> of the consultation paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation. Please indicate to which paragraph(s) your comment refers to.</p>		
Reference	Comment	
General Comment		
Introduction		
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3.4.2	<p>The analysis concludes that the 99.5% stresses vary significantly by age. I would argue that the need for simplicity is not a strong enough argument for propping stresses independent of age here, as this may significantly distort the SCR for specific blocks of business. I would note that allowing the stresses to vary by age would not necessarily require undertakings that do not already use two-dimensional mortality tables to introduce them, as the stresses could be parameterised to vary by attained age instead of by current age.</p> <p>I would also note that the analysis presented relates to uncertainty in mortality rates over the full projection period, whereas the SCR should in principle be considering changes over one year in the best estimate of mortality rates.</p>	
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7.2		
	<p>I disagree with paragraph 455 and believe the Smith-Wilson extrapolation methodology should be used, for the following reasons:</p> <ul style="list-style-type: none"> • It is not clear from the first reason given for not using the Smith-Wilson methodology what simulations with different UFR values have been performed. However the stresses should reflect how the UFR would in practice change under the stress scenarios, namely that the change would be restricted to +/-15bp under the EIOPA methodology for setting the UFR. The ORSA is the proper place to allow for the risk that the UFR will change by the maximum amount in the same direction year after year. • The second reason given for not using the Smith-Wilson methodology is, in my view, a red herring. EIOPA already publish stressed yield curves derived by linear interpolation/extrapolation between the points specified in Articles 166 and 167 of the Delegated Regulation. There would not appear to be any reason why they should not instead publish stressed yield curves derived by Smith-Wilson interpolation/extrapolation. • The third reason given for not using the Smith-Wilson methodology should not be an issue provided the calibration includes all maturities where a deep, liquid and transparent market exists. 	
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7.4.3	<p>Proposal B is preferable to Proposal A. There are macroeconomic as well as statistical reasons to believe that interest rates will tend to be less volatile in absolute terms in a low yield environment than in a medium yield environment.</p>	
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8.4.2	<p>Alternative 2 represents a clear improvement over the current approach, which ignores all information apart from external ratings where there are exposures to multiple related</p>	

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	<p>counterparties.</p> <p>Paragraph 568 expresses concern that other information such as solvency ratios might be less relevant to the credit risk, or that there might be 'cherry-picking'. However this can be mitigated by modifying Article 186(2) of the Delegated Regulation so as not to allow as low a risk factor for the highest solvency ratios as for the highest credit qualities in Article 186(1).</p>	
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9.4.2	<p>The proposal seems reasonable. However I wish to take this opportunity to draw EIOPA's attention to the fact that there exist currencies pegged to the US dollar as well as currencies pegged to the euro, and these currencies are not currently provided for in Article 188 of the Delegated Regulation. If currency X is pegged to the US dollar and the currency down stress is biting for currency X, but the currency up stress is biting for the US dollar, then it is perverse to insist that the capital requirements for these two currencies be added together. Instead it should be possible to calculate a single capital requirement for both currencies together.</p>	
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10.4.2.3	<p>The weighted average approach to assessing financial ratios is conceptually more logical than the threshold approach provided the internal assessment process is able to detect any serious weaknesses that would otherwise be highlighted by the threshold approach.</p>	

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	The yield criterion as proposed is unlikely to give useful results. Introducing a dependency on maturity, as suggested in paragraph 680, is vital to ensure that the yield differences are due to differences in credit risk. The reference to yields on CQS 4 bonds seems arbitrary.	
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	<p>It is not possible to conduct a proper assessment of the relative merits of the two proposed methods for implementing the 'look-through approach' without considering the relationship between them. At a high level there are two differences between the methods:</p> <ol style="list-style-type: none"> 1. The stressed loss method uses data only over the period of the financial crisis, whereas the beta method as presented uses data over a longer period. 2. The stressed loss method considers industry sector and leverage only, whereas the beta method considers a longer list of factors. <p>My comment is therefore that 1. and 2. should be considered separately. The conclusion may then be reached that the best method is a combination of the two proposed.</p>	
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13.3	The simplification proposed to Article 200 of the Delegated Regulation is most unlikely to be used in practice, since it never produces a lower SCR and uses no less data. Consideration should be given to extending the analysis that produced the figures of 3 and 5 standard deviations to produce a table of values between which undertakings would interpolate. This would eliminate the discontinuity that currently exists.	
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14.4.3	Option 1 is to be preferred for the probability of default and recovery rate. There would not appear to be any reason not to move to maximum consistency with banking regulation, as central clearing represents a genuine reduction in default risk compared with bilateral transactions, even with counterparties rated AAA. Regarding the implications for the loss given default, the assumption that the value of the underlying asset varies evenly over the year may not be appropriate for all types of underlying. It may therefore be appropriate to leave the standard formula unchanged, i.e. Option 1, while allowing undertakings that can justify a weaker calibration for their types of underlying to develop an internal model.	
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15.4.3	<p>The proposal to carve out unit-linked and index-linked assets from the 20% limit where there is no significant SCR impact seems appropriate.</p> <p>Caution is required before extending this carve-out to cases where the SCR impact is offset by an impact on future profits, as suggested in paragraph 1217, as the allowance for future profits would need to be sufficiently prudent. As per my response to Chapter 17, such an allowance may not be appropriate at all in a solvency valuation, beyond the one-year time horizon of Solvency II Pillar 1.</p>	
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16.3.3	<p>The current approach here can only be considered anomalous, given that the underlying data has to be collected in any case to perform the solo SCR calculations. Option b) is therefore to be preferred.</p> <p>Consideration of the circumstances in which it is appropriate to allow for diversification benefits should take the existing provisions for ring-fenced funds as a starting point.</p>	
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17.4.3	<p>My position is that a solvency valuation should not include any allowance for new business beyond the one-year time horizon of Solvency II Pillar 1. Once one starts to make exceptions to this principle, it introduces unnecessary complexity since one then has to ensure the allowances for new business are sufficiently prudent.</p> <p>The ORSA is the proper place within Solvency II for testing whether the business plan, including in particular its impact on the tax position of the undertaking, is sustainable.</p>	
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18.4.3	<p>The least realistic part of the risk margin calculation is that the reference undertaking is assumed to hold the liabilities until they become a tontine. In reality the market expects consolidation to occur and so market prices of transactions are unlikely to assume the full standalone SCR would be held in the later years of the projection.</p> <p>I do not believe there is a method of addressing this flaw in the CoC approach that is simple enough to be specified in the Delegated Regulation. The least bad option would seem to be to calibrate the CoC rate consistently with transactions observed in practice. In this regard, I would question the assertion on page 267 of the CP that market prices are typically not directly observable, given that regulators typically have extensive powers to request information from the firms they regulate.</p>	
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