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CEIOPS' Advice on Solvency II Level 2 implementing measures – third set

Dear Jörgen,

Following your letter of 12 June 2009, in which you asked CEIOPS to deliver final advice on the vast majority of areas covered in the first and second round of consultation by October 2009 and agreed on a third set to be finalized by January 2010 on other areas where changes had been made to the Level text in the last stages of negotiation, I am pleased to submit to you the final advice which has been adopted during CEIOPS Members' Meeting held on 26 and 27 January 2010.

During the consultation held on 16 papers from November to December 2009, CEIOPS received 6.856 comments on the individual papers from 126 stakeholders (CP 63 – 77 and 79) from national and European associations and insurance undertakings. Around 36% of the submissions came from insurance companies, mutuals and groups and 31 % from other stakeholders (for example consultants, investment banks, law firms). The remainder of the comments were submitted by national and European associations.

CEIOPS has embraced a transparent and successful process in resolving the issues, considering the very short time frame and the limited possibility to further discuss with stakeholders in finalising the advice. CEIOPS has aimed to revise and improve its advice with due consideration to the comments received.

Hereunder, I would like to point out some specific areas that have arisen from this third set of advice, the responses received and the revisions made.

In general, stakeholders commented on the limited time available for the consultation and the split between the advice on the calibration (third set) and the structure and design of the risk modules (second set). CEIOPS considered this was a pragmatic approach to the tight time schedule set by

the European Commission and has published its time schedule and the areas to be covered by the different sets of advice in advance.

Stakeholders have criticised a lack of overall assessment of the impact by CEIOPS when producing its advice. However, CEIOPS has aimed particularly at providing advice which is consistent among the different Pillars and risk modules. Eventually, all pieces of advice must be read together to ensure an appropriate view of CEIOPS' position.

CEIOPS has revised its calibration papers taking into account to the extent possible stakeholders' comments and recognising concerns with regard to the increase in calibration of the SCR standard formula compared to QIS4. To ensure that the parameters and correlation coefficients in the formula are set commensurate with the aim of the 99.5 % VaR, CEIOPS has undertaken extensive **further statistical analysis** for those areas where data was made available, also taking into account the relevant information gathered during the financial crisis. This does not preclude that in the future, when more data will have been collected, further improvements shall be made to the calibration proposals and adequate review mechanisms shall be established in order to reflect the evolution of risks.

A **first assessment** was carried out to establish the impact of the proposed changes to the SCR as calculated according to the standard formula. CEIOPS notes, however, that it would not be sufficient to only consider the SCR for such an impact assessment. The effect of the Level 1 principles and Level 2 measures on the valuation of assets, the level and quality of own funds and the amount of technical provisions also have to be taken into account when assessing the capital surplus that will be available for undertakings under Solvency II. Furthermore, any overall estimate of the impact of the changes would need to consider the assumptions and limitations of the chosen benchmark (such as QIS4) and is unlikely to fully capture the impact on individual insurers, which is likely to differ depending on the insurer's risk profile. The overall assessment of the impact of the proposals on the undertakings' balance sheets will therefore be **extensively tested in QIS5**.

With regard to the changes made to the calibration of the **market risk** module, the overall impact most likely results on average in a significant decrease of the market risk charge compared to the charge proposed in the initial Consultation Paper. However CEIOPS notes that the revised charge remains higher compared to QIS4, mainly due to the fact that some of the calibrations under QIS4 (for example spread risk) were not based on sufficient evidence. CEIOPS has also revised the correlations based on further analysis and the impact of the new correlations certainly leads to a lower overall risk charge.

With regard to the equity risk calibration, the final advice contains a majority and minority view for the "global" equity risk charge, ranging from 45% to 39%, with one member supporting a 32% stress.

In other issues, such as **non-life underwriting risk**, CEIOPS agrees that further data should be collected. Although, unfortunately, not sufficient data input has been provided by stakeholders up till now, CEIOPS has undertaken a major effort to refine its calibration proposals by collecting further data from its Members or revising the assumptions. In order to progress the analysis of the new data, CEIOPS has asked the Commission to finalise its **advice on non-life risk, as well as health and MCR calibration for the QIS5 draft technical specifications by the end of March 2010**. The Commission has agreed for CEIOPS to continue its analysis and to involve stakeholders for providing support.

CEIOPS will invite key stakeholders to discuss in the month of February the progress made on the calibration of the above mentioned risk modules and capital requirement for the MCR. CEIOPS would strongly encourage stakeholders to provide concrete and realistic proposals for inclusion in CEIOPS work (for example on non-proportional reinsurance or by making available concrete evidence for further analysis of non-life underwriting risk during the consultation on QIS5 specifications).

In the meanwhile, CEIOPS is developing further Level 3 guidance, which should help a smooth transition to Solvency II, such as for example by preparing the reporting templates, monitoring the pre-application process for the approval of internal models, and ensuring the preparedness of colleges of supervisors.

In the next months, CEIOPS will continue providing assistance to the Commission by preparing the draft technical specifications for the fifth quantitative impact study (QIS5) and further work on specific aspects will be undertaken (for example on the inclusion of model error in the calculation of undertaking specific parameters). CEIOPS notes in particular that the output from CEIOPS TF on the illiquidity premium will also need to be taken into account when finalising the QIS5 specifications.

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

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'G. Bernardino', with a stylized flourish above the name.

Gabriel Bernardino

CEIOPS Chair