	Comments Template on Discussion Paper on the review of specific items in the Solvency II Delegated Regulation	Deadline 3 March 2017 23:59 CET
Name of Company:	Aon UK Limited	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
	Please follow the following instructions for filling in the template: ⇨ 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 empty. ⇨ Please fill in your comment in the relevant row. If you have no comment on a paragraph or a cell, keep the row empty. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. **Please send the completed template, in Word Format, to CP-16-008@eiopa.europa.eu** **Our IT tool does not allow processing of any other formats.** The numbering of the questions refers to the discussion paper on the review of specific items in the Solvency II Delegated Regulation.	
Reference	**Comment**	
General Comment		
Q1.1		
Q1.2		
Q1.3		
Q1.4	Captives issue both global policies and local policies. Local policies are issued where necessary with respect to local requirements and these policies will have consistent terms and conditions as the master policy, where possible. In either case the insured, the single large corporate parent, is constant and therefore the risk practice standards will not differ by region. Whilst it is true that	Public

	claims experience will not be perfectly correlated by region, we do not believe that the geographic benefit for captives would be significant given the single insured. We would suggest a simplified approach for captives would be to allocate all exposures regardless of underlying geographic exposure to a single region. This is particularly relevant for captives where the premium / reserve exposures are not captured at a country level and significant effort is required to manipulate the exposures by region to allow a small geographic benefit to be derived.	
Q1.5	The lapse risk calculation is required to be completed at an individual policy level. However, for both captives and small / medium sized commercial (re)insurers this is an onerous requirement. Reserving is generally not completed on an individual policy level and so an allocation of premium provision to policy needs to be performed before applying individual cancellation terms to the policies. A pragmatic approach that some (re)insurers have been adopting is to group up policies by inception month, where the cancellation terms will be consistent and requires a less granular allocation of the premium provision.	Public
Q1.6	Captives are set up to cover the risks of a single parent. They are not exposed to lapse risk consistent with a commercial (re)insurer competing with other (re)insurers, this is reflected in historically low lapse rates. We would suggest that captives be exempted from the calculation given the immateriality when compared to the overall SCR.	Public
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Q1.20	Money Market Funds: Many captives invest in money market funds because they are highly liquid and highly secure. These funds contain a diversified asset portfolio of short dated and highly rated instruments. The risks associated with these investments are low and straightforward and thus appropriate for a captive. As such, where nature, scale and, complexity of risk are concerned, the standard formula may be overly onerous. The guidelines on the look-through approach state that "Undertakings should apply the look-through approach to money market funds." Due to the many underlying securities, employing a full look-through approach can be relatively complex and time consuming relative to the riskiness of the investments (for example there is no straightforward mapping from short term ratings to CQS). Given that money market funds can be independently rated as a whole fund, a provision for using this rating and treating the fund as a whole would be a useful provision for captives when using the standard formula. This would be a simple to implement within spread risk as the fund could be treated as a single fixed income asset (inevitably the duration floor of 1 would be triggered), though it may be sensible to consider lower charges as the floor would be a large overstatement of the sensitivity of money market funds to credit spread volatility. The aspect of the calculation that would require greater concessions is concentration risk, where treating the fund as a single exposure would be ignoring its structure as a diversified portfolio of money market instruments. It would be justifiable however to make an exception for money market funds, providing that the definition of what qualifies as a money market fund, for the purposes of the proposed simplification, were such that, had a full look-through been employed, the fund would generate no concentration risk charge. Below is a proposed definition. Definition: ▪ Single Currency (such that the Currency Risk calculation would be unaffected)	Public

	▪ Weighted average maturity/life of assets < 270 days ▪ Fund has credit quality step 2 or greater (mapping from mf ratings i.e. S&P AAA-mf, AA-mf etc.) ▪ No exposure to any non-sovereign/government issuer greater than 3% (hence concentration risk should be zero) Additional Conditions for consideration: ▪ Condition on the short term rating of instruments in the fund ▪ Were a fund to be multicurrency, a requirement on it being hedged back to the fund currency ▪ A restriction on the amount of asset backed commercial paper – e.g. 15% A simpler alternative to the above would be to allow captives to perform the calculation on a representative portfolio (prudently constructed as per the guidelines) as opposed to a full look-through. Another alternative to the above would be to include money market funds in counterparty risk, to reflect the fact that the investment characteristics of money market funds are very similar to cash at bank – and in many cases better due to the large diversification within the fund vs cash at a single bank. Were the money market fund to be represented as one single name exposure, the charge in the counterparty default risk would be commensurate with (and actually slightly higher than) the spread risk charge for the fund. Furthermore the charge for counterparty default risk is more strongly correlated with non-life insurance risk, which is often the key driver of a captive's SCR.	
Q1.21	Mapping money market instruments to CQS, as they typically carry only short term ratings due to their very short duration.	Public
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Q1.26	The non-life catastrophe calculations are very onerous requiring a large amount of data to complete. Captive risk profiles are not complex with policies issued on standard terms to a single insured, often with an outwards aggregate limit to ensure the net loss to the captive is always within a defined level. This feature allows a corporate parent to evaluate the risk that the captive is underwriting without having to be an insurance expert. This outwards aggregate will either be provided by a highly rated global panel of reinsurers, or a sister captive. The standard formula for captives often results in significant volume of work to calculate the gross catastrophe losses, only to have to limit the net position at the outwards aggregate, which is known at the outset. This effectively means the value of applying the full calculation only allows the undertaking to appreciate the exposure to reinsurers in a 1-in-200 scenario, however, given the highly rated reinsurance panel; this would not be a key risk to the captive. For captives writing non-compulsory lines, where the insured is limited to a single parent who is also the owner of the captive, the cost required to collate the information and complete the calculations is disproportionate compared to evaluating the reinsurance exposure. We would suggest a proportionate approach consistent with point 21 of the introduction to Directive 2009/138/EC, and Article 109 of this Directive, would be to allow captive entities to calculate their global catastrophe exposures based on a premium calculation.	Public
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Q5.1	Yes, the definition of $FP_{(future)}$ should be updated to ensure that 100% of the exposure is included within the premium risk calculation. Currently, the definition excludes exposure earned between 12 months following the valuation date and 12 months after the initial recognition date. The impact of this definition on the SCR is dependent on when the exposure incepts, with inception dates closer to 12 months following the valuation date having more exposure excluded from the calculation. We would suggest a revised definition of "denotes the expected present value of premiums to be earned by the insurance and reinsurance undertaking in the segment *s* for contracts where the initial recognition date falls in the following 12 months but excluding the premiums to be earned during the 12 months after the valuation date".	Public
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Q7.1	We support a number of captives underwriting property exposures that relate to a single parent company. These captives are often underwriting commercial and industrial risks with large gross limits, in a number of countries, but across a limited number of sites within a country. Relative to the average European insurer these captives are unlikely to be writing a diversified portfolio by property type or geography, nor with an average deductible and an insured to value relationship. In this instance it is unlikely that the EIOPA calibrations will accurately reflect the risk profile of the captives property exposures. As noted within the consultation paper the natural catastrophe calculations are very onerous and require very granular data. For captive entities with limited or no staff and supported by an external resource, it is very difficult to collate and manage the required data to complete these calculations. We would suggest a proportionate approach consistent with point 21 of the introduction to Directive 2009/138/EC, and Article 109 of this Directive, would be to allow captive entities to calculate their EEA natural catastrophe exposure consistent with the Non-EEA calculations, which is a premium based calculation.	Public
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Q12.1	Article 211 of the Delegated Acts states that reinsurance recoverables cannot be considered as admissible risk mitigation for the BSCR calculation if they are with a reinsurer who is outside the EEA, based in a non-equivalent regime and with a credit quality step below 3. The technical specifications are clear that there should be consistency between the Solvency II balance sheet and the SCR calculation. However, there is no explicit guidance on the treatment of non-equivalent, unrated reinsurance recoverables in the valuation of technical provisions for the Solvency II balance sheet. Considering the Solvency II balance sheet as being on a "best estimate" basis, we believe that it is reasonable to assume that credit can be taken for these recoveries on the balance sheet, provided an appropriate allowance is made for the potential default of the unrated reinsurer. This approach implies that the balance sheet reinsurance recoverables should also be included in the market risk and counterparty default risk modules, in order to stress the balance sheet appropriately.	Public

	While the recoveries are clearly inadmissible for Premium & Reserve risk and Catastrophe risk as per Article 211, we believe credit needs to be taken for these recoverables when considering lapse risk, otherwise there will be a mismatch between premiums that have already been paid to the reinsurer and the future claims associated with these premiums i.e. lapse risk would be overstated if the recoveries were not considered in this module. The future reinsurance claims should be consistent with the reinsurance premium provision allowed for on the Solvency II balance sheet. Furthermore, we believe credit should be taken for these recoverables when calculating the MCR, as this is outside the BSCR calculation referred to in Article 211.	
Q12.2	Article 201: Part 2a) - 'the sum over all possible combinations (j,k) of different combinations' we feel is open to misinterpretation. A clearer instruction, less open to misinterpretation, we feel would be to make the sum over j, k ; j > k.	Public
Q12.3	Article 200: There is a step change in the calculation, from 3σ to 5σ that depends on ratio of the standard deviation of the loss distribution and the total losses given default. This cliff edge with an increase of a factor of 5/3 has the potential to give extremely unstable results, particularly when the counterparty risk module is a driver of the overall SCR (for example a captive with a large quota share). This feature of the calculation is difficult to justify, and the volatility it causes can be problematic. In addition, it can result in the risk margin SCR being larger than the base SCR (e.g. if the balance of assets shifts when minimising market risk, so that the risk margin SCR is calculated at 5σ but the base SCR is calculated at 3σ. We would suggest removing this step change, and either fixing the multiple (e.g. at 5σ) or making it a different, but continuous, function of σ. Article 201: The derivation of the expressions for the variance terms is unclear. Again, this makes it difficult to	Public

	explain and unpick the real drivers of the charge. Some clarification over the origin of the expressions V_{inter} and V_{intra} would help in understanding them, or alternatively a simplified version that is more transparent would be desirable. In addition, a simple example considering two counterparties existing with the same credit rating (and hence probability of default), demonstrates non intuitive behaviour. The calculation for these counterparties will only contain a V_{intra} term. Any minor improvement in the probability of default of one of the counterparties leads to the introduction of the V_{inter} term, while the V_{intra} term is largely unchanged. This could have a material impact, and means the improvement in default probabilities leads to a worsening of the risk charge. Including the V_{intra} term as part of the V_{inter} calculation and summing over counterparties rather than probabilities of default would be a potential route to address this.	
Q12.4	We feel the points discussed in our response to Q12.3 (Article 200 and Article 201) are also relevant for this question - the fact that these parts of the calculation are unclear is mostly driven by the overly complex nature of them.	Public
Q12.5	A simplification we feel would be to remove the step change in Article 200. A further simplification which would clarify the calculation and make it more aligned with the methodologies employed elsewhere in the Standard Formula would be: ▪ Calculate the probability of default (PD) and loss given default (LGD) for each counterparty as currently ▪ Calculate the variance of the expected loss distribution as a Bernoulli trial i.e. $(1\text{-}PD) * PD * LGD^2 = \sigma^2$. ▪ Calculate the overall variance of the expected loss distribution, V by adding the σ values together via a correlation matrix, with e.g. 0.25 off the diagonal. ▪ Calculate the 1-in-200 year expected loss by taking $3\sqrt{V}$	Public

	This could be refined by correlating insurers with insurers, banks with banks etc.	
Q12.6	The simplification would save time in the calculation, and also time and costs explaining and understanding any changes in the charge. It is also more intuitively risk sensitive. Currently a single counterparty of credit quality step 6 defaults 4.2% of the time, i.e. it will default in the 1 in 200 year scenario. However, the charge generated is less than the loss given default, which means the loss given default / probability of default, is not behaving as expected. This simplification corrects this.	Public
Q12.7	We feel this simplification should supersede the current calculation. If not, captive insurance companies should be able to use it.	Public
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