

Comments on Consultation 30-09 Draft L2 Advice on TP - Treatment of Future Premiums

Name company: PricewaterhouseCoopers LLP UK

Please insert your comments in the table below, and send it to secretariat@ceiops.eu in word format. In order to facilitate processing of your comments, we would appreciate if you could refer to the relevant section and/or paragraph in the Consultation Paper 30-09.

Reference	Comment
General comment	<p>Overview and context</p> <p>We welcome the fact that CEIOPS is looking to develop proposals that are consistent with IFRS. The CP refers in this respect to the IASB - Insurance Contracts 'Discussion Paper' ("DP") published in May 2007. The DP recommended a measurement basis of "Current exit value" being 'the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity.'</p> <p>In this context Article 75 of the Solvency II Level 1 text (approved in April 2009) states that, "The value of technical provisions shall correspond to the current amount insurance and reinsurance undertakings would have to pay if they were to transfer their insurance and reinsurance obligations immediately to another insurance or reinsurance undertaking." This is in principle consistent with the DP above establishing a measurement basis by reference to a 'transfer value'. Both bases are intended to be an 'economic' basis of valuation. This is an important principle and context for CP30 and is reflected in some of our more detailed comments below.</p> <p>We note however that the IASB continue to debate the appropriateness of this measurement basis and consequently CEIOPS may choose to reassess the IASB proposals as they develop and consider any potential impact on this and other relevant CP's.</p>

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CP30 – Key Principles

This CP seeks to provide advice with regard to the treatment of future premiums in the assessment of technical provisions required under Article 76 of the Level 1 text. Our understanding of the key principle which underpins CP30 is that only the cashflows relating to existing obligations should be recognized in the solvency balance sheet. In this context existing obligations include any liabilities which cannot be avoided by the insurer through a unilateral right to reject any future premium or an unlimited ability to amend the premium or the benefits (or otherwise re-underwrite the risk) at some point in the future.

Para 3.15 goes on to state that in circumstances where, “a policyholder option to increase the future premiums by means of an option to renew the contract, to extend the insurance coverage to another person and the insurance or reinsurance undertaking cannot react in one of the ways described above (see para 3.13)...,” and this gives rise to an **expected loss** from the additional future premiums then this loss is deemed to relate to the existing contract and should be included in the technical provisions.

By contrast Para 3.19 states that where such additional future premiums give rise to an **expected profit** for the undertaking the cashflows would not be deemed to relate to the existing contract as there exists no policyholder obligation to pay future premium. In support of this distinction the CP argues that were future profitable premiums to be included then there would exist an opportunity for arbitrage to the extent that undertakings could choose in most jurisdictions to change the terms of the contract to offer its policyholders an equivalent option and lower its best estimate provisions.

In conclusion para 3.22 states that, “future premiums and any resulting benefit payment to policyholdersbelong to the existing contract (and hence as we understand it create an existing obligation) if, and only if, the inclusion of the renewals increase the best estimate”.

Key issues arising

(1) Economic basis of valuation

In adopting an economic basis of valuation based on a ‘transfer value’ measurement basis there is a strong argument that if credible experience indicates that a proportion of policyholders would take up policyholder options then **profits as well as losses** on these future expected premiums would be considered by a third party in assessing an appropriate transfer value. Using an economic transfer value would be fundamentally different to the rule set out in para 3.22.

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CEIOPS should make clear why, if it is seeking to adopt a transfer value principle, it has chosen to limit the recognition of future premiums in this way.

We note that for many life insurance contracts, future premium will be needed to recover initial costs of acquisition. We again question the need to restrict premium recognition in this way.

(2) Granularity of assessment

Para 3.24 requires that principles of the CP should be applied at the contract level. Whilst it acknowledges this may be difficult in some circumstances it only allows a higher level of assessment where the results do not materially differ from that on a per contract basis. We question the degree of granularity that should be adopted. Our concern is that failure to adopt a portfolio logic will lead to excessively prudent assumptions.

Other observations

We note CP30 uses definitions consistent with IAS39 although note the principles in relation to de-recognition are likely to change and consequently CEIOPS may choose to assess the impact of any changes on CP30.

CP30 does not make any specific comments in relation to Investment Contracts and nor have we in our response. CEIOPS may want to consider Investment contracts specifically before issuing final guidance.