

**Comments Template on CEIOPS-CP 46
Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility**

**Deadline
11.09.2009
4 p.m. CET**

Name of Company:	PricewaterhouseCoopers LLP	
Disclosure of comments:	CEIOPS will make all comments available on its website, except where respondents specifically request that their comments remain confidential. Please indicate if your comments should be treated as confidential:	No
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ <u>Do not change the numbering</u> in the column “reference”. ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph, keep the row <u>empty</u>. \ ⇒ Our IT tool does not allow processing of comments which do not refer to the specific paragraph numbers below. <ul style="list-style-type: none"> ○ If your comment refers to multiple paragraphs, please insert your comment at the first relevant paragraph and mention in your comment to which other paragraphs this also applies. ○ If your comment refers to sub bullets/subparagraphs, please indicate this in the comment itself. <p>Please send the completed template, <u>in Word Format</u>, to secretariat@ceiops.eu. Our IT tool does not allow processing of any other formats.</p> <p>The numbering of the paragraphs refers to Consultation Paper No. 46 (CEIOPS-CP-46/09).</p>		
Reference	Comment	
General Comment	We welcome the opportunity to comment on this CP. We note that the limit structure restrictions proposed for the Level 2 implementing measures are significantly more stringent than the minimum requirements set out in the Level 1 Directive. The CP	

**Comments Template on CEIOPS-CP 46
Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility**

**Deadline
11.09.2009
4 p.m. CET**

	<p>does not provide sufficient justification as to how CEIOPS has arrived at the specific limits now proposed and (as set out in paragraph 3.46) the impact assessment has not yet been published. Given the importance of these proposals, and the extent to which they exceed the Directive’s minimum requirements, we encourage CEIOPS to publish, as part of the third set of advice, a more detailed justification for its proposals alongside the impact assessment.</p> <p>We are concerned with that the proposal that supervisory approval should be required prior to any redemption of capital instrument may restrict the availability of capital. Whilst prior supervisory approval may be desirable in certain circumstances (e.g. on a proposed early repayment of an instrument by an insurer) the requirement for supervisory approval on all redemptions (including at contractual maturity where repayment would not lead to a breach of MCR or SCR) may limit the willingness of providers of capital to invest in such instruments.</p> <p>We set out our detailed comments on these and a number of other areas under the relevant paragraphs below.</p>	
1.		
1.1.		
1.2.		
1.3.	We concur that it seems logical to deal with both classification and eligibility together.	
1.4.		
1.5.	Whilst it is acknowledged that learning from the crisis is critical, it should not result in an excessively cautious approach and specific justification should be provided to support any proposals resulting from the crisis.	
1.6.	It is unclear when transitional arrangements from Solvency I to Solvency II will be addressed. To the extent the criteria governing the eligibility of capital are more stringent under Solvency II than under Solvency I the existence of appropriate transitional measures (including the potential “grandfathering” of existing capital instruments) may be of critical importance.	
2.		
2.1.		

**Comments Template on CEIOPS-CP 46
 Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility**

**Deadline
 11.09.2009
 4 p.m. CET**

2.2.		
3.		
3.1.		
3.2.		
3.3.		
3.4.		
3.5.		
3.6.		
3.7.		
3.8.		
3.9.		
3.10.		
3.11.		
3.12.		
3.13.		
3.14.		
3.15.		
3.16.		
3.17.		
3.18.		
3.19.		

**Comments Template on CEIOPS-CP 46
Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility**

**Deadline
11.09.2009
4 p.m. CET**

3.20.		
3.21.		
3.22.		
3.23.		
3.24.		
3.25.		
3.26.		
3.27.	It would be helpful if more clarity could be given to the interpretation of “construed narrowly”.	
3.28.		
3.29.	<p>The fact that loss absorption has not been observed in respect of certain types of instruments should not be taken as evidential of the fact that those instruments are not capable of absorption of losses (for example if losses have been absorbed by the reduction of dividends on ordinary shares then those same losses cannot also be absorbed by the deferral of coupons on hybrid instruments).</p> <p>Nor should the fact that certain instruments may, in practice, absorb more earnings in times when profits are made be taken as evidential as to the extent that those instruments would absorb losses in periods when losses are incurred.</p> <p>Own funds in Tiers 1 and 2 are required by Article 94 to substantially possess the loss absorbency characteristics specified by Article 93. If instruments do not substantially possess those characteristics they will not qualify for inclusion within that Tier of own funds. It is therefore unclear why further restrictions would be needed to ensure the appropriate level of loss absorbency.</p>	
3.30.		
3.31.	Clarification would be welcomed as what would constitute “significantly higher” together with the rationale for CEIOPS arriving at that quantification.	
3.32.		

**Comments Template on CEIOPS-CP 46
Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility**

**Deadline
11.09.2009
4 p.m. CET**

3.33.	Option b) would be preferable to option a) as it acknowledges the possibility that a hybrid capital instrument / subordinated liability is capable of meeting the Tier 1 characteristics and should therefore be permitted to be included in Tier 1 if it does so. Option a) seems unduly restrictive and potentially contrary to Article 94(1) which mandates that own fund items shall be included in Tier 1 if they possess the necessary characteristics. As set out in paragraph 3.35 there may be circumstances where other instruments are considered to have the characteristics of Tier 1.	
3.34.		
3.35.	Whilst a flexible approach in stressed circumstances would be welcomed, it is envisaged that setting out criteria for inclusion would be challenging and there is a concern that there may be inconsistent application throughout the Member States. We therefore concur that the criteria for inclusion in these circumstances would need to be developed to ensure a consistency of approach.	
3.36.	An approach to allow inclusion of such instruments within Tier 1 subject to the addition of certain safeguards would appear proportionate.	
3.37.		
3.38.	We concur that Tier 1 items should be fully paid up.	
3.39.		
3.40.		
3.41.		
3.42.		
3.43.		
3.44.	Article 94(3) states (emphasis added) “ Any basic and ancillary own fund items which do not fall [to be classified as Tier 1 or Tier 2] shall be classified in Tier 3.” Given the requirements of this Article it is unclear what basis exists within the Level 1 text for excluding any items that meet the definition of	

Comments Template on CEIOPS-CP 46 Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility		Deadline 11.09.2009 4 p.m. CET
	either basic or ancillary own funds from Tier 3.	
3.45.		
3.46.	Given the importance of these proposals, the understanding of their impact should be key in assessing their suitability. CEIOPS should not therefore finalise its views on the limit structure proposed in this CP until it has considered stakeholders' comments on the impact assessment to be published in the third set of consultations.	
3.47.	<p>The coverage of the SCR requirement would seem to go further than that set out in article 98.1 where although Tier 1 must be greater than a third of own funds and Tier 3 less than one third, the relative mix between Tier 2 and 3 is not limited i.e. Tier 2 could form up to 2/3 of own funds with Tier 1 the other third. The revised proposal would prevent the use of Tier 3 own funds in the absence of any Tier 2 own funds. This might impact the current own funds situation of some companies. See further comments on paragraph 3.50 to illustrate this concern.</p> <p>The requirement for MCR appears consistent with the Level 1 text.</p>	
3.48.	A requirement setting a minimum level of Tier 1 and a maximum level of Tier 3 would be preferable to allow the use of Tier 3 in the absence of Tier 2 capital (which may be harder to raise in the current climate than Tier 3).	
3.49.	The meaning of this paragraph is unclear. Is it effectively saying that given that MCR is calibrated at 45% of MCR and SCR should be covered 50% by Tier 1, then MCR is automatically covered by Tier 1?	
3.50.	<p>Further to the comments on paragraph 3.47 above, in the example given in this paragraph the entity covers its SCR by a mixture of Tiers 1, 2 and 3. Consider an alternative entity which rather than having Tier 1 of 50 and Tier 2 of 35 had instead Tier 1 of 85 and Tier 2 of zero (with the Tier 3 being unchanged). This entity would appear unarguably to have a stronger capital base (the only change being 35 of Tier 2 being replaced with the same amount of higher quality Tier 1 capital). However, based on the restrictions proposed in paragraph 3.47 this entity would be unable to count any Tier 3 towards its SCR and so be unable to cover its SCR as required by the proposed rules.</p> <p>The proposed restrictions therefore require reconsidering to ensure that such counterintuitive results are not achieved (for example by basing any limit on the use of Tier 3 on the aggregate of Tier 1 and eligible Tier 2 rather than on eligible Tier 2 alone).</p>	

**Comments Template on CEIOPS-CP 46
Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility**

**Deadline
11.09.2009
4 p.m. CET**

3.51.	If the proportions in the example in 3.50 were altered to 45%, 40% and 15% the SCR coverage would be breached but not the MCR coverage which is still entirely covered by Tier 1. However it is agreed that below that level a simultaneous breach of both SCR and MCR coverage would occur.	
3.52.	A lower MCR coverage by Tier 1 than 100% would therefore be preferable. However the 80% proposed is higher than that currently in article 98.2 of the Directive and CEIOPS should clearly rationalise the basis for selection of this level.	
3.53.		
3.54.		
3.55.		
3.56.		
3.57.		
3.58.	The wording should read "assets over liabilities" rather than "assets of liabilities" and in the second sentence "own funds" should read "basic own funds".	
3.59.		
3.60.	<p>We agree that to qualify as Tier 3 basic own funds subordinated liabilities should demonstrate features to ensure that subordination is effective. However, there may be other ways of achieving this (via contractual terms governing payment of interest and repayment of capital) other than requiring supervisory approval for repayment.</p> <p>Potential providers of own funds would face uncertainty as to whether and when a supervisor may approve a repayment and this uncertainty may limit the availability of subordinated capital.</p> <p>Consideration should therefore be given to defining circumstances when subordination would be effective without, in all cases, requiring supervisory approval of any repayment (for example by only requiring supervisory approval in cases of a proposed repayment by the insurer prior to the contractual redemption date).</p>	
3.61.	There may be practical difficulties in implementing this recommendation as it may impinge on the legal rights of the providers of own funds.	

Comments Template on CEIOPS-CP 46 Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility		Deadline 11.09.2009 4 p.m. CET
3.62.	See comments on 3.60.	
3.63.		
3.64.		
3.65.		
3.66.	We concur that a reporting date approach is logical.	
3.67.	A reporting date basis is currently maintained in certain Member States (e.g. the UK) which suggests that the potential difficulties in administering and interpreting are not insurmountable. Given the low percentage of Tier 2 and Tier 3 own funds currently in issue (paragraph 3.11) by insurers this may be less of an issue than envisaged.	
3.68.	<p>It might be necessary for there to be transitional arrangements to ensure that some instruments are grandfathered – it may not be practical to require existing instruments to contain a requirement that supervisory approval be obtained before redemption or coupons are paid.</p> <p>See also the comments on paragraph 3.60 regarding the proposed need for prior supervisory approval for redemption. If the intention is that supervisory approval is required for any redemptions (including those at normal maturity of the instrument) this would effectively make all items of own funds of indeterminate length at the option of the relevant supervisor (irrespective of other contractual terms). This may limit the availability of capital and effectively make redundant the proposals elsewhere in the consultation regarding the maturity terms of capital.</p>	
3.69.		
3.70.		
3.71.		
3.72.		
3.73.		
3.74.		
3.75.		

Comments Template on CEIOPS-CP 46 Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility		Deadline 11.09.2009 4 p.m. CET
3.76.		
3.77.		
3.78.		
3.79.		
3.80.		
3.81.		
3.82.		
3.83.		
3.84.	It is not clearly articulated why it is desirable to mirror the banking regime with regard to deepest subordination given the additional costs undertakings would have to incur. It is unclear the basis on which deepest subordination (as opposed to subordination) is considered to be a requirement of the Directive for an item to be classified as Tier 1.	
3.85.	<ul style="list-style-type: none"> i) it is unclear whether it is envisaged that more than one instrument could be deeply subordinated to the same degree. Otherwise potentially only one capital instrument could therefore rank as Tier one. ii) The loss absorbency criterion seems to accept that more than one instrument could rank equally. Taking into account the comments on subparagraph i), explicit clarification of this point would be welcome. iii) Existing instruments may not contain this feature and grandfathering arrangements may need to be considered. iv) v) As for iii) there may be practical difficulties for existing instruments. 	
3.86.		
3.87.		

Comments Template on CEIOPS-CP 46 Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility		Deadline 11.09.2009 4 p.m. CET
3.88.		
3.89.		
3.90.		
3.91.		
3.92.		
3.93.		
3.94.		
3.95.		
3.96.		
3.97.		
3.98.		
3.99.		
3.100.	<p>a) It is unclear how such reserves would be measured and guidance on this should be provided.</p> <p>b) Given Article 94(3) it is unclear what the basis within the directive for excluding deferred tax assets in their totality from own funds. The approach of including assets which do not possess the characteristics of Tiers 1 or 2 within Tier 3 would appear more consistent with the Level 1 text.</p> <p>c) Given Article 94(3) it is unclear what the basis within the directive for excluding intangible assets in their totality from own funds. The approach of including assets which do not possess the characteristics of Tiers 1 or 2 within Tier 3 would appear more consistent with the Level 1 text (although in practice given the proposals in CP35 will largely preclude the valuing of intangible assets this distinction is unlikely to be of great</p>	

**Comments Template on CEIOPS-CP 46
Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility**

**Deadline
11.09.2009
4 p.m. CET**

	practical relevance).	
3.101.		
3.102.	The tentative conclusion of the IASB is to preclude the recognition of a profit on inception for accounting purposes. It would be helpful for CEIOPS to articulate its position from a solvency perspective on the assumption that the IASB maintains this stance for accounting purposes.	
3.103.		
3.104.		
3.105.		
3.106.		
3.107.		
3.108.		
3.109.		
3.110.		
3.111.		
3.112.	Would such repayments require prior supervisory approval? Or is it that they would not be prevented provided the SCR is not breached?	
3.113.		
3.114.		
3.115.	ix Existing instruments may not contain this lock in feature and grandfathering arrangements may need to be considered. Requiring consent of the supervisory authority would result in uncertainty for	

**Comments Template on CEIOPS-CP 46
Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility**

**Deadline
11.09.2009
4 p.m. CET**

	providers of funds. xi see comments under ix above.	
3.116.		
3.117.	Article 94 requires that “Any basic and ancillary own fund items which do not fall under paragraphs 1 and 2 shall be classified in Tier 3.” This article imposes no further requirements on Tier 3 own funds and makes no reference to the requirements of Article 93 in this regard. To read the absence of a reference to another Article as an indication that the Article not referred to should not be “disregarded” would appear to be imputing a meaning to the text which is not actually present.	
3.118.		
3.119.	Any element of the excess of assets over liabilities that does not fall within Tier 1 or Tier 2 would fall within Tier 3 by virtue of Article 94(3) without any reference to subordination. The statement in this paragraph does not therefore appear correct in respect of such elements.	
3.120.		
3.121.	There may be difficulties in placing such restrictions in contracts	
3.122.		
3.123.		
3.124.		
3.125.		
3.126.		
3.127.		
3.128.		
3.129.		
3.130.		

Comments Template on CEIOPS-CP 46 Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility		Deadline 11.09.2009 4 p.m. CET
3.131.		
3.132.		
3.133.		
3.134.		
3.135.		
3.136.		
3.137.		
3.138.		
3.139.	This appears to allow all of the supplementary member calls to be capable of being treated as Tier 2 subject to limits. If this interpretation is correct a little more clarification would be helpful.	
3.140.		
3.141.		
3.142.		
3.143.		
3.144.		
3.145.		
3.146.	It would be preferable to ensure that the level 2 implementing measures are sufficiently detailed to avoid the need for level 3 supervisory guidance.	
3.147.		
3.148.		
3.149.		
3.150.		

**Comments Template on CEIOPS-CP 46
Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility**

**Deadline
11.09.2009
4 p.m. CET**

3.151.		
3.152.		
3.153.		
3.154.		
3.155.		
3.156.		
3.157.		
3.158.		
3.159.		
3.160.		
3.161.		
3.162.		
3.163.		
3.164.		
3.165.		
3.166.	This seems a sensible approach.	
3.167.		
3.168.	See comments in 3.31	
3.169.		
3.170.		
3.171.		

**Comments Template on CEIOPS-CP 46
 Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility**

**Deadline
 11.09.2009
 4 p.m. CET**

3.172.		
3.173.	See comments at 3.47.	
3.174.	See comments at 3.51 and 3.52.	
3.175.		
3.176.		
3.177.		
3.178.	See 3.60.	
3.179.		
3.180.		
3.181.		
3.182.		
3.183.		
3.184.	The approach to base the duration on cash flows is preferred to that based on maturity of insurance liabilities.	
3.185.		
3.186.		
3.187.		
3.188.		
3.189.		
3.190.		
3.191.		
3.192.		

**Comments Template on CEIOPS-CP 46
Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility**

**Deadline
11.09.2009
4 p.m. CET**

3.193.		
3.194.		
3.195.		
3.196.		
3.197.		
3.198.		
3.199.		
3.200.		
3.201.		
3.202.		
3.203.		
3.204.		
3.205.		
3.206.		
3.207.		
3.208.		
3.209.		
3.210.		
3.211.		
3.212.		
3.213.		

Comments Template on CEIOPS-CP 46 Consultation Paper on the Draft L2 Advice on Own Funds – Classification and Eligibility		Deadline 11.09.2009 4 p.m. CET
3.214.		
3.215.		
3.216.		
3.217.		
3.218.		
3.219.		
3.220.		
3.221.		
3.222.		
3.223.		
3.224.		
3.225.		
3.226.		
3.227.		