

**Comments Template on CEIOPS-CP 47
 Consultation Paper on the Draft L2 Advice on SCR Standard Formula – Market Risk**

**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. 47 (CEIOPS-CP-47/09).</p>		
Reference	Comment	
General Comment	We have no significant criticism of the proposals in this paper in relation to certain elements of the market risk module of the SCR standard formula. However, we note that a large amount of the detail of the calculation is still to be developed (e.g. equity risk sub-module, correlations between sub-modules, the majority of the calibration) and that our comments are thus somewhat limited in scope.	

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	<p>We note that only the concentration risk sub-module includes the explicit instruction to calculate the capital charge both with and without allowance for management actions in respect of future discretionary benefits. Given that this information is required for the calculation of the loss-absorbing capacity of technical provisions, as described in CP 54, we suggest that such instructions are either included in all sub-modules or outlined as an overall requirement within the market risk module.</p>	
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4.9.	It would be helpful to clarify that "option take-up behaviour" includes the option to discontinue a policy. This comment also applies to paragraph 4.12.	
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4.11.	This paragraph refers specifically to the impact of interest rate hedging instruments. Does it apply equally to other instruments hedging other market risks, for example equity futures or options?	
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4.14.	We suggest that this paragraph should read "Assets and liabilities sensitive to interest rate movements..." Otherwise, it would be useful to clarify why "insurance liabilities" are included in a list of assets sensitive to interest rate movements.	
4.15.	We suggest that it is the present value of future liability cash flows, rather than the cash flows themselves, that is sensitive to changes in the discount rate.	
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4.24.	<p>We query why it is proposed to stress the volatility of interest rates but not of other asset classes. In addition, we note that the intention to stress the volatility of interest rates (or of other asset classes) could have onerous practical implications for firms with a material level of embedded guarantees in their business, due to the resulting requirement to recalibrate their stochastic model.</p> <p>We suggest that volatility stresses are fully tested in QIS5 to investigate whether the resulting capital requirements are significant enough to justify the extra work involved in their calculation.</p>	
4.25.	<p>While developing the calibration of the interest rate stresses, it would be useful to consider how an insurer should treat exposure to foreign interest rates. We suggest that the appropriate stresses for yield curves in different currencies should be derived consistently but should not necessarily be the same. Consideration should also be given to the materiality of the exposure to foreign interest rates.</p> <p>In addition, we query whether the calibration will make any distinction between the nominal and the real term structures of interest rates.</p>	
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4.42.	<p>Foreign equities where the currency risk is not hedged are specifically included in currency risk, with the explanation that this is because the risk is not captured by the equity stress. However, typical equity portfolios invest “overseas” to gain better diversification and exposure to wider industrial sectors. National currency equities often invest broadly overseas so are themselves carriers of “currency risk”. This complexity of SCR stress may well drive unintended consequences such as more concentrated equities exposure limited to national currency. This could be avoided by either a) introduction of a diversification credit for foreign to local equities, or b) limits on foreign equities up to which no currency risk is required (2.5% of assets if in OECD economies).</p> <p>In addition, we note that it is not clear how other foreign asset classes should be treated. For example, is the currency risk on (unhedged) foreign bond holdings to be included within the interest rate sub-module or the currency sub-module?</p> <p>This comment also applies to paragraph 4.50.</p>	
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4.64.	<p>Firms are permitted to take account of credit spread risk hedging programmes when calculating the capital charge. Given the basis risk inherent in many hedging programmes, we suggest that further guidance should be given on “proper treatment” of these risks.</p> <p>This comment also applies to paragraph 4.82.</p>	

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4.80.	The spread stress is to be rating agency driven for most of the instruments. Some guidance is needed where different rating agencies rate an asset at different levels, and whether to accept internal "ratings" calculated by the insurance undertaking itself for unrated assets.	
4.81.	Given that rating agencies are to be relied on for the bulk of the assets, it is not obvious why scenario analysis is needed for the counterparty to credit derivatives.	
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4.88.	We question whether making distinctions between different types of property is a worthwhile exercise, in terms of the additional complexity it introduces relative to any perceived benefits. This comment also applies to paragraph 4.95.	
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4.125.	<p>We note the arguments in this paragraph supporting a reduction in the concentration thresholds relative to QIS4. However, we also note that in order to achieve diversification such as that exhibited by the MSCI World Index, an undertaking would be exposed to significant currency risk and a resulting onerous capital charge. We are thus concerned that the concentration thresholds proposed in this paper are too low and thus unduly burdensome. We urge CEIOPS to test them fully in QIS5.</p> <p>These comments also apply to paragraph 4.152.</p>	
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4.143.		
4.144.	Greater clarity is required on how to treat asset exposures where there is no external credit rating.	
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4.152.	See comments at paragraph 4.125.	
4.153.	The evaluation of the impact on the value of options and guarantees of each excess exposure will be computationally intensive. Some companies may be willing to adopt approximations instead of re-running their valuation models for each excess exposure in isolation. Would approximate computation of $\Delta Liab_{ul}$ be permitted?	
4.154.		
4.155.	Part of the calculation would appear to have been omitted, as the previous two paragraphs described the calculation of $Conc_i$, i.e. the capital charge at the level of each excess exposure. Should paragraph 4.159 be positioned before this paragraph? Should it refer to $Mkt_{conc_financial}$ rather than to Mkt_{conc} ? The formula currently presented at paragraph 4.155 is not easily understood. Is it the intention to say that the calculation has so far been carried out ignoring any management actions in respect of future discretionary benefits ("gross", in the terminology of CP 54) and that an adjustment for these actions is now required to give the "net" amount for the purposes of CP 54?	
4.156.	The description of the adjustment for future profits is unclear. This comment also applies to paragraphs 4.157 and 4.158.	

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4.159.	See comment at paragraph 4.155 re the positioning of this paragraph.	
4.160.	What is the meaning of “concentration threshold of the sub-module” as the definition of CT? CT has only previously been defined (paragraph 4.152) at the level of an individual counterparty, depending on its credit rating.	
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4.163.	Is there any criterion specifying what is meant by “high correlation”?	
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4.169.	Should the formula refer to $Mkt_{conc_properties}$ rather than to Mkt_{conc} ?	
4.170.	We suggest that reference is made to Mkt_{conc} in this paragraph.	
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Annex A		
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