

<b>Comments Template on CEIOPS-CP 54</b> <b>Consultation Paper on the Draft L2 Advice on SCR Standard Formula – Loss absorbing capacity of TP</b>		<b>Deadline</b> <b>11.09.2009</b> <b>4 p.m. CET</b>
Name of Company:	<b>PricewaterhouseCoopers LLP</b>	
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"> <li>⇒ <b>Do not change the numbering</b> in the column “reference”.</li> <li>⇒ 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>.</li> <li>⇒ 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"> <li>○ 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.</li> <li>○ If your comment refers to sub bullets/subparagraphs, please indicate this in the comment itself.</li> </ul> </li> </ul> <p><b>Please send the completed template, in Word Format, to <a href="mailto:secretariat@ceiops.eu">secretariat@ceiops.eu</a>. Our IT tool does not allow processing of any other formats.</b></p> <p>The numbering of the paragraphs refers to Consultation Paper No. 54 (CEIOPS-CP-54/09).</p>		
Reference	Comment	
General Comment	Our detailed comments on the paper are set out below. Overall, we strongly support the “single equivalent scenario” approach to calculating the adjustment for loss-absorbing capacity of technical provisions, as we do not believe the “modular” approach can allow for appropriate treatment of changes to future discretionary benefits. Furthermore, we believe that the single equivalent scenario	

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	<p>should be identified based on the individual capital charges calculated net, rather than gross, of changes to future discretionary benefits. We explain our reasoning for this position in more detail in our comments on paragraph 3.55 below.</p> <p>We note that there is no consideration, either here or in CP 55 on the calculation of the MCR, of the implications of the SCR being reduced to near zero as a result of the loss-absorbing capacity of technical provisions, a position noted in the second bullet point of paragraph 3.16. This is a significant possibility for UK insurers with closed with-profits funds, where the insurer must allow for the gradual distribution to policyholders of all assets within the fund, although any non-profit fund is likely to contribute a non-zero value to the SCR. If the SCR is reduced to zero, the cap on the MCR would result in the absolute floor on the MCR biting, which may seem like an anomalously low criterion for large with-profits firms to meet.</p>	
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3.12.	The 3 <sup>rd</sup> bullet point highlights one point emerging from QIS4 – if bonuses are increased in the stress where interest rates increase, the net SCR may be higher than the gross SCR. No advice appears to have been included in this paper to address this eventuality. We suggest it would be useful to include such advice.	
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3.19.	As stated in our response on CP 39 (paragraph 3.180), from a consistency perspective it would be helpful to link the definition of conditional and pure discretionary benefits to the IFRS definition of “discretionary participation feature.”	
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3.25.	We welcome the aim to achieve consistency in the criteria which must be met by assumptions regarding future management actions, whether applied in the calculation of technical provisions or in the assessment of the standard formula SCR. These comments also apply to paragraph 3.82.	
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3.41.	We strongly agree with the statement that the gross calculation of the SCR is hypothetical and does not reflect economic reality. However, we acknowledge that it has some use within the context of the standard formula and is a requirement of the Level 1 text.	
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3.43.		
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3.46.	<p>The proposed approach may present practical difficulties, for example where models are coded to vary the conditional discretionary benefits in line with the legal or contractual rules. Applying the rules presented in this table would require such coding to be overridden.</p> <p>We note that the proposed rules in this paragraph are not currently reflected in the advice in paragraphs 3.82 to 3.104.</p>	
3.47.		
3.48.	<p>The second definition (i.e. that presented in paragraph 3.47 as opposed to that presented in paragraph 3.44) appears to have distinct practical advantages in terms of ease of calculation, as described in the 2<sup>nd</sup> and 3<sup>rd</sup> bullet points of this paragraph. Given the acknowledgement that the gross SCR is in any case a hypothetical construct, it is hard to argue that either definition could have a significant technical advantage over the other. We would thus favour adopting the more pragmatic approach, which appears to be option 2.</p> <p>These comments also apply to paragraph 3.87.</p>	
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3.54.	<p>We have a strong technical preference for the single equivalent scenario approach. In reality, the individual market and underwriting stresses are highly unlikely to occur in isolation and so each allowance for changes in future discretionary benefits will by necessity be very approximate. The use of a single equivalent scenario in which all stresses occur to different extents is likely to present a</p>	

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	<p>much more realistic picture to which management would expect to react. The obvious avoidance of double counting of the effects of changes to future discretionary benefits, the requirement for only a single run net of management actions and the ability to consider the loss-absorbing capacity of deferred taxes within the same scenario are all strong practical arguments in favour of this approach.</p> <p>However, this is reliant on the single equivalent scenario approach becoming more widely understood and we welcome CEIOPS’s plans to facilitate this. We strongly agree with the sentiments in paragraph 3.52 that blind reliance on a tool provided by the supervisor is undesirable – it is imperative that undertakings adopting this approach have a full understanding of how it works.</p> <p>Given the limited testing of the single equivalent scenario approach in QIS4, we recommend that CEIOPS carries out further testing in QIS5 following its initiative to educate undertakings on the approach before reaching a final conclusion.</p>	
3.55.	<p>We accept and welcome the fact that undertakings will be permitted to base the identification of the single equivalent scenario on capital charges net of changes to future discretionary benefits. Management actions are often strongly based around market performance rather than insurance risks. A single scenario based on gross capital charges may thus be heavily skewed towards market risks while that based on net capital charges has a much heavier weighting towards insurance risks because management actions pass much of the market risk on to policyholders. It is this latter scenario which presents the more accurate picture of the risk profile of the undertaking itself.</p> <p>We thus question whether it is appropriate to present the use of gross capital charges as the default option in Level 2 text. We believe that undertakings should be given an equal choice between gross and net capital charges in order to encourage deeper consideration of the most appropriate approach.</p> <p>These comments also apply to paragraphs 3.56, 3.57 and 3.97.</p>	
3.56.	See comments on paragraph 3.55.	
3.57.	See comments on paragraph 3.55.	
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3.70.	<p>This paragraph notes that only deferred tax liabilities may be reduced as "deferred tax assets lose their value if the financial situation of the undertaking deteriorates". Although this can be the case, there will be situations where value can reasonably be expected to be recovered against a deferred tax asset as a result of the shock, either as a new asset is created or by netting off an asset against an existing liability. A key factor in determining the valuation of the deferred tax asset is the length of the period over which value is expected to be recovered.</p> <p>An example of a reduction in a deferred tax liability covered by this paragraph may be where the shock results in lower equity values, resulting in reduced unrealised gains. However, to the extent that a deferred tax asset is created which could be recovered against an existing deferred tax liability, or realised in some other way (e.g. losses which could be carried back in the same entity against profits of an earlier period, or surrendered as group relief in the current period) then it would seem reasonable that this was factored in to some extent.</p>	
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3.82.	See comments on paragraph 3.25.	
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3.87.	We favour option 2 due to its practical benefits; see comments on paragraph 3.48.	
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3.89.	We strongly favour option 2, the single equivalent scenario approach. It should be included in Level 2 text at least as an available option and preferably as the favoured or default option.	
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3.97.	See comments on paragraph 3.55 in relation to the use of gross or net capital charges to identify the single equivalent scenario.	
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