



## Solvency II implementing measures

# Wave 2: Building blocks for the final Directive

On 2 July 2009 the Committee of European Insurance and Occupational Pensions Supervisors ('CEIOPS') released a second wave of Consultation Papers<sup>1</sup> ('CPs'), setting out draft guidance on Level 2 implementing measures for Solvency II. Following the consultation process, CEIOPS' final advice will be submitted for consideration and, if appropriate, formal adoption by the European Commission in 2010. The European Commission is not, however, bound to accept the advice of CEIOPS. CEIOPS has requested responses on the CPs from all stakeholders and all responses must be submitted by 11 September 2009.

The Level 1 text identifies specific articles where implementing measures are required to come into force at the same time as the Level 1 directive, and other articles where implementing measures may be developed in parallel or later (or may rely solely on supervisory guidance at Level 3). The Commission has requested early indications of CEIOPS' advice in relation to these latter articles simultaneously with its advice on the required implementing measures. In all cases, CEIOPS' advice must clearly adhere to the provisions of the Level 1 text. CEIOPS can also cover those areas where the text provides that the Commission may seek guidance.

Any other article will not be the subject of specific guidance from CEIOPS (e.g. on the form and content of an ORSA) and there will be no further elaboration by way of any implementing measure.

There are a number of references in the CPs to matters being reserved for Level 3 guidance (i.e. specific guidance for supervisors). It is not clear at present whether stakeholders will be consulted in relation to this guidance, although there are good precedents for this happening. It is therefore important to make sure that there is an appropriate balance between prescription in Level 2 and matters to be subject to supervisory discretion as provided for under Level 3 measures.

The second wave comprises 24 CPs in addition to an addendum to CP37 ('Advice on the procedure to be followed for the approval of an internal model'), which cover six broad areas of the Solvency II Directive.

This document provides a brief overview of the areas covered by the CPs in addition to a brief summary of each CP.

### Technical provisions: CPs 39 to 45

These CPs cover various aspects of the scope, detail and standards for the calculation of technical provisions and include guidance on the application of the principle of proportionality. CEIOPS highlights the choice of discount rate in CP40 as one of the areas in respect of which comments would especially be welcomed - the issue of allowance for an illiquidity premium within the discount rate (which is not supported by the great majority of CEIOPS members) is likely to be a key consideration, particularly for those writing annuity business.

### Capital and capital requirement: CPs 46 to 55, and 57

These CPs develop various sub-modules of the SCR standard formula calculation, including treatment of operational risk. Guidance is also provided on the calculation of the MCR, capital add-ons and the use of own funds. Calibration remains unclear and will be the subject of later CPs. CEIOPS would especially

welcome comments on the assessment of the excess of assets over liabilities in CP46 and on certain areas in CP57 relating to capital add-ons.

### Regulatory reporting: CP58

This CP develops reporting requirements for groups and solo undertakings, including consideration of external audit requirements.

### Application of Solvency II to groups: CPs 60 to 62, and addendum to CP37

These CPs provide advice on what will constitute a group for group solvency purposes, group solvency calculations, various aspects of group supervision and group internal model approval. They currently go further than the Level 1 text in certain areas and provide guidance on group risk concentrations and intra-group transactions.

### Internal models: CP56

This CP further develops CEIOPS' guidance on internal model approval for solo undertakings.

### Remuneration: CP59

This CP contributes CEIOPS' views to the debate on remuneration issues, and sets out advice on principles to be applied and the role of supervisory authorities.

### Future developments

PricewaterhouseCoopers plans to respond to the key issues affecting our clients and we will post our responses on our website.<sup>2</sup> If you have any strong views on any of these papers or would like to discuss their content with us, contact Mark Batten, Partner at PricewaterhouseCoopers (contact details overleaf).

A third wave of CPs is scheduled to be released by CEIOPS in early November 2009.

<sup>1</sup> Available on CEIOPS' website at [www.ceiops.org](http://www.ceiops.org)

<sup>2</sup> [www.pwc.com/solvencyii](http://www.pwc.com/solvencyii)

#### CP39: TP – Best estimate

CP39 provides further advice on the appropriate methodologies for the calculation of the best estimate.

#### CP40: TP – Risk-free interest rate

CP40 provides advice on the relevant risk-free interest rate term structure to be used in the calculation of technical provisions.

#### CP41: TP – Calculation as a whole

CP41 provides advice on the circumstances in which technical provisions may be calculated as a whole (i.e. not separated into a best estimate and a risk margin).

#### CP42: TP – Risk margin

CP42 specifies the overall structure of the calculation of the risk margin, including definition of reference undertaking, calibration of the cost of capital rate and projection of future SCRs.

#### CP43: TP – Standards for data quality

CP43 sets out standards around the appropriateness, completeness and accuracy of data used in the calculation of technical provisions, including use of data approximations.

#### CP44: TP – Counterparty default adjustment

CP44 advises on the methods to be used when calculating the counterparty default adjustment to recoverables from reinsurance contracts and special purpose vehicles.

#### CP45: TP – Simplifications

CP45 considers the principle of proportionality in terms of the use of simplified techniques in the calculation of technical provisions, proportionate to the scale and complexity of the risks.

#### CP46: Own funds –

##### Classification and eligibility

CP46 sets out advice on the classification and eligibility of own funds. Transitional requirements will be covered by a later paper.

#### CP47: SCR standard formula – Market risk

CP47 provides advice on the structure and design of the interest rate, spread, currency, property and concentration risk sub-modules of the standard formula.

Calibration is not covered (with the exception of concentration risk).

#### CP48: SCR standard formula – Non-life underwriting risk

CP48 covers the scope, methods, assumptions and parameters used in the non-life underwriting risk module. Calibration, standard deviations, catastrophe and undertaking specific parameters, correlations and simplifications will be covered in a later CP.

#### CP49: SCR standard formula – Life underwriting risk

CP49 covers the design, structure and calibration of the life underwriting risk module. Correlations and simplifications (excluding lapse risk) will be covered in a later CP.

#### CP50: SCR standard formula – Health underwriting risk

CP50 covers the scope and calculation of the capital requirement for the health underwriting risk sub-module. CEIOPS will continue to work on advice on calibration and simplifications.

#### CP51: SCR standard formula – Counterparty default risk

CP51 complements the advice given in CP28, and sets out further advice on the calculation of the capital requirement for counterparty default risk.

#### CP52: SCR standard formula – Reinsurance mitigation

CP52 sets out qualitative criteria to ensure effective risk transfer to a third party and the consequent adjustments to the capital requirement. The paper is complementary to CP31 and is intended to be read in conjunction with CPs 36 and 60.

#### CP53: SCR standard formula – Operational risk

CP53 provides advice on the treatment of operational risk.

#### CP54: SCR standard formula – Loss-absorbing capacity of TP

CP54 sets out advice on the calculation of the adjustment for loss-absorbing capacity of technical provisions.

#### CP55: SCR standard formula – MCR calculation

CP55 specifies the detail of the calculation of the MCR, although some points of calibration will be covered in a later CP.

#### CP56: Tests and standards for internal model approval

CP56 provides further detail on the approval of internal models, including group models, and seeks to foster a harmonised approach to internal model approval. Approval of partial internal models will be covered in a separate CP.

#### CP57: Capital add-on

CP57 provides advice on the setting of capital add-ons at a solo and group level, exploring several alternative options.

#### CP58: Supervisory reporting and disclosure

CP58 develops reporting and disclosure requirements for solo undertakings and groups using standard formula or an internal model.

#### CP59: Remuneration issues

CP59 contributes CEIOPS' views on remuneration policy and provides Level 2 advice on remuneration issues, including general principles for remuneration policy and the role of supervisory authorities in the context of remuneration.

#### CP60: Group solvency assessment

CP60 provides advice on the scope and calculation of group solvency and the group SCR.

#### CP61: Intra-group transactions and risk concentrations

CP61 develops CEIOPS' views on the supervision of intra-group transactions and risk concentrations, including how these are captured and managed in a group supervision framework.

#### CP62: Cooperation and colleges of supervisors

CP62 discusses the coordination of group supervision.

#### Addendum to CP37: Procedure to be followed for the approval of a group internal model

This addendum deals with the procedures, additional to those set out in CP37, for the approval of a group internal model.

**If you would like to discuss any of the areas covered in this paper, as well as the implications for yourself and your firm, please contact:**



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