

Comments Template on CEIOPS-CP 41 Consultation Paper on the Draft L2 Advice on TP – Calculation as a whole		Deadline 11.09.2009 4 p.m. CET
Name of Company:	European Insurance CFO Forum	
Disclosure of comments:	<p>CEIOPS will make all comments available on its website, except where respondents specifically request that their comments remain confidential.</p> <p>Please indicate if your comments should be treated as confidential:</p>	No. The CFO Forum comments are not confidential.
<p>Please follow the following instructions for filling in the template:</p> <p style="padding-left: 40px;">Do not change the numbering in the column “reference”.</p> <p>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>.</p> <p>Our IT tool does not allow processing of comments which do not refer to the specific paragraph numbers below.</p> <p style="padding-left: 40px;">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.</p> <p style="padding-left: 40px;">If your comment refers to sub bullets/subparagraphs, please indicate this in the comment itself.</p> <p>Please send the completed template, in Word Format, 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. 41 (CEIOPS-CP-41/09).</p>		
Reference	Comment	
General Comment	<p>The CFO Forum believes that the scenarios which render cash flows non-replicable are too restrictive.</p> <p>In the current drafting of the consultation paper, the requirements under which cash flows can be</p>	

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	<p>replicated are too high a hurdle to be used in practice. We recommend that the requirements are relaxed.</p> <p>See comments in 4.14 and 4.23 for more details.</p> <p>The application of the principle of proportionality should be stated within this guidance.</p> <p>The CFO Forum recommends that this guidance should state that the principle of proportionality applies. For example, in the event where there are cash flows that cannot be replicated, which form a very small portion of the total cash flows, then it should be permissible to calculate the technical provisions as a whole for the total cash flows, without unbundling the non-replicable cash flows.</p>	
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4.12.	<p>Mark-to-model practices remain reliable where used appropriately and should be retained.</p> <p>The CFO Forum agrees that market observable prices should be used for valuation where there is a deep, liquid and transparent market; however mark-to-model techniques remain valid when such markets do not exist.</p> <p>This paragraph encourages the use of marking to deep, liquid and transparent markets and notes mark-to-model practices “as one of the main sources of the financial crisis”.</p> <p>The CFO Forum agrees that the use of mark-to-model practices for complex financial instruments where the underlying risk have not been properly understood has contributed to the financial crisis, however, this does not mean that the techniques employed are necessarily bad and they will provide more reliable estimates when properly adjusted for otherwise not reflected risks. The industry would retain the use of mark-to-model practices.</p>	

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4.14.	<p>The scenarios which render cash flows non-replicable are too restrictive.</p> <p>A possible alternative would be to split a currently non-replicable cash flow into hedgeable and non-hedgeable components.</p>	
4.15.	Comments in 4.24 are also relevant here.	
4.16.	The CFO Forum does not believe unbundling is required for a pure unit-linked contract (without any additional guarantee).	
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4.23.	<p>The basis for identifying observable reliable market values in a “deep, liquid and transparent market” is too restrictive and the guidelines should be more applicable in practice. The CFO Forum believes that the IFRS Exposure Draft definition is more appropriate although note that the associated guidance would require revisiting.</p> <p>The CFO Forum considers that in many instances the best value for insurance liabilities is a market value adjusted for risks not reflected in that market price, rather than a pure modelled approach with a tenuous link to financial market values.</p> <p>Possible amendments include:</p> <ul style="list-style-type: none"> Aligning the definition with that of active markets used in the IFRS Exposure Draft for Fair Value Measurement: “A market in which transactions for the asset or liability take place with 	

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	<p>sufficient frequency and volume to provide pricing information on an ongoing basis.” The CFO Forum highlights, however, that the guidance in this exposure draft in relation to inactive markets is circular and needs to be revisited.</p> <ul style="list-style-type: none"> • Change the first bullet point to require that market values are adjusted for variation in future cash flows not reflected in the replicating cash flows to achieve a reliable estimate. • The third point, “The properties are expected to be permanent”, should be deleted as the characteristics of markets do change and it is unclear how markets should be treated if they subsequently fail to meet the definition. <p>The market for AAA government bonds may not meet the “deep, liquid and transparent” definition as large volume transactions may impact price.</p> <p>The first requirement that large volume transactions can be executed with little impact on the prices of instruments used in the replicating portfolio is not always achievable for large volumes of AAA government bonds yet this is the proposed basis for discount rates in CP40.</p> <p>Replicating portfolios can provide a good basis for determining the discounted value of future cash flows and associated financial risks. Such approaches should be permitted whilst recognising the need to adjust for variability in those cash flows due to non-financial risks.</p>	
<p>4.24.</p>	<p>The CFO Forum considers unbundling to be inappropriate as the cash flows arising from financial and insurance components of the contracts are interdependent.</p> <p>The CP proposes that cash flows that can be replicated are unbundled from cash flows that cannot be replicated.</p> <p>For most insurance contracts, the CFO Forum considers unbundling to be inappropriate as the cash flows arising from financial and insurance components of the contracts are interdependent and this reduces the reliability of estimates. Solvency II guidelines on unbundling cash flows should be consistent with IFRS 4 paragraph 10 as follows:</p> <p><i>“Some insurance contracts contain both an insurance component and a deposit component. In some cases, an insurer is required or permitted to unbundle those components:</i></p>	

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	<p>a) <i>unbundling is required if both the following conditions are met:</i></p> <ul style="list-style-type: none"> i) <i>the insurer can measure the deposit component (including any embedded surrender options) separately (i.e. without considering the insurance component).</i> ii) <i>the insurer's accounting policies do not otherwise require it to recognise all obligations and rights arising from the deposit component.</i> <p>b) <i>unbundling is permitted, but not required, if the insurer can measure the deposit component separately as in (a)(i) but its accounting policies require it to recognise all obligations and rights arising from the deposit component, regardless of the basis used to measure those rights and obligations.</i></p> <p>c) <i>unbundling is prohibited if an insurer cannot measure the deposit component separately as in (a)(i)."</i></p> <p>Further information on unbundling with respect to unit-linked policies is requested. The CFO Forum believes that unbundling for unit-linked policies should be permitted but not required, as per the IFRS 4 definition.</p> <p>In the evaluation of insurance contracts it can be more appropriate and practical to model the distinct characteristics of a series of cash flows, rather than trying to unbundle the actual cash flows themselves, which are interdependent.</p> <p>The CFO Forum recommend that the last sentence of this paragraph is changed to say "If the proposed unbundling is not appropriate, for example due to the interdependence of replicable and non-replicable cash flows, the replicable characteristics of those cash flows may be assessed using replicating techniques and separate calculations of the best estimate and the risk margin shall be required for the characteristics of the contract not included in the replicating techniques used."</p>	
4.25.	<p>The first sentence in this section, "CEIOPS considers that the proposals developed in this advice are the only possible in order to prevent in the future crisis like the current one", is too rigid and should be removed.</p>	

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4.26.	The paragraph is ambiguous about whether the constituents of the portfolio or the portfolio itself need to be observable in the market. The paragraph should be updated to reflect the proposed treatment.	
4.27.	The CFO Forum requests additional practical examples to illustrate the scenario described in this paragraph.	
4.28.	<p>In the current drafting of the consultation paper, the requirements under which cash flows can be replicated are too high a hurdle to be used in practice.</p> <p>The current conditions for using replicating methods are too onerous. We recommend that the requirements in relation to cash flows are relaxed and consideration is given to the valuation of different characteristics of those cash flows using replicating methods.</p> <p>In particular we note that:</p> <ul style="list-style-type: none"> • Under the second condition, factors such as discretionary policyholder participation should be added; • Under the third condition we note that there are very few cash flows that are not affected by biometric developments, and therefore not considered to be reliably replicable, under these proposals; • The third conditions specified, "one or several features of the future cash flow depend on the development of factors external to the undertaking for which there are no financial instruments for which reliable market values are observable." <p>The current conditions for using replicating methods are too onerous. We recommend that the requirements in relation to cash flows are relaxed and consideration is given to the valuation of different characteristics of those cash flows.</p> <p>Comments in 4.24 are also relevant here.</p>	