Date

17 January 2007

Le Président

Fédération des Experts Comptables Européens AISBL

Av. d'Auderghem, 22-28
1040 Bruxelles
Tél. 32 (0) 2 285 40 85
Fax: 32 (0) 2 231 11 12
E-mail: secretariat@fee.be

Mr. Henrik Bjerre-Nielsen
Chairman
CEIOPS
Sebastian-Kneipp Str. 41
60439 Frankfurt / Main
Germany

Email: secretariat@ceiops.org

Dear Mr. Bjerre-Nielsen,

Re: CEIOPS – **CP-08/06** Draft Advice to the European Commission on Supervisory Reporting and Public Disclosure in the Framework of the Solvency II Project,
CEIOPS – **CP-07/06** Draft Advice to the European Commission in the framework of the Solvency II project on supervisory powers" and
CEIOPS – **CP-09/06** Draft Advice to the European Commission in the framework of the Solvency II project on further advice on Pillar I issues".

FEE (Federation of European Accountants, Fédération des Experts Comptables Européens) welcomes the opportunity to comment on the Consultation Papers no. 15, no. 18 and no. 20. FEE is the representative organisation for the accountancy profession in Europe with membership of 44 professional institutes of accountants from 32 countries in total representing more than 500.000 accountants in Europe.

Given the complexity of the issues addressed in these documents and the number of consultations launched in the same period, we are concerned that the reduced consultation period will hinder CEIOPS's mission to consult extensively and in an open and transparent manner, (Article 5, European Commission Decision 2004/6/EC of 5 November 2003) and, consequently, result in less comprehensive, useful responses. We would also like to mention that we have a due process to respect within our organisation in responding to consultation, made very difficult by such a short comment period. This may also be the case for other organisations responding to CEIOPS.

Regarding Consultation Paper no. 18 on Supervisory Powers, we are satisfied with the way the paper considers the relationship between auditors and insurance undertakings, taking into account the different possible legal environments which form the basis of this relationship. We would not support CEIOPS proposing to supervisors to require additional work from auditors for supervisory purposes without establishing appropriate engagement terms between the auditor and the regulated entity.

Our comments on Consultation Paper no. 15 and no. 20 are attached.

We would be pleased to discuss any aspect of this letter with you.

Yours sincerely,

Jacques Potdevin
President

APPENDIX

Consultation Paper no. 15 – Supervisory Reporting and Public Disclosure

General Comments

We understand that the advice appears in shaded boxes whereas the other parts of the Paper have an explanatory character. It is unclear to what extent the list of individual disclosures set out in Section 4 are expected to become mandatory or are intended to be implementation guidance within the future Solvency II regulation. Also it is unclear whether the information required in Section 4 should be publicly disclosed or provided on a private basis to regulators. Some of the information included in Section 4 goes well beyond what is normally disclosed in financial statements. We are concerned that CEIOPS may assume that any information necessary for supervisors should be given in the public disclosures within the financial statements. If there is to be additional public reporting beyond the information which is expected to be disclosed in GAAP financial statements, this should be part of regulatory disclosures. This proposal should be clarified. For example, it is not clear as to whether the first bullet point of 5.6 will be required for private supervisory reporting only or for public disclosure. Such information includes sensitive data and it may be inappropriate to disclose it publicly.

Whilst consistency with disclosure requirements for general purpose financial reports, especially IFRS based financial statements, is attractive there is no reason why it necessarily will be appropriate. IFRS financial statements will include many disclosures which may also assist in achieving market discipline. However, we consider the detail required for regulatory purposes may well extend beyond that needed in general purpose financial statements which have already become in many instances unwieldy documents. The expertise of supervisors (CEIOPS or IAIS) can assist IASB to ensure that useful information is covered by IFRS disclosure requirements for insurers. We encourage CEIOPS to be more involved in the IASB discussion to allow reasonable consistency in disclosure requirements where appropriate as it has happened in the past with the involvement of the Basel Committee in developing IFRS 7. That would allow the additional disclosure requirements of regulators to be limited to those disclosures which are especially relevant for policyholders, potential policyholders or supervisors whose information needs are not the main focus of the IASB.

If under Solvency II additional disclosures are required to those in IFRS, special care is recommended to avoid inconsistency. Disclosures based on different authorities can result in inconsistent messages to the public, with consequent confusion and irritation. If different information is needed it should be clear from the regulatory public disclosures why those differences arise.

From our experience already with IFRS 4, the volume of disclosure to be provided is a critical issue. There needs to be a balance of substance and volume. An undue quantity of information does not serve the user well and the effort for the insurer is excessive, disregarding the fact that excessive data will usually impair its quality. Any published regulatory disclosure requirements in addition to those in IFRS need to bear these matters in mind.

Specific comments

4.7 Second bullet point: it may be considered to require segmental reporting not only with respect to performance but also with respect to assets and liabilities.

We suggest mentioning in this respect other well recognised non-financial performance indicators, such as lapses, but in doing so we consider it should be made clear that only relevant performance measures need to be disclosed.

4.9 Sixth bullet point: a separation of technical provisions between the best estimate and the risk margin is rather artificial. If for example a percentile approach is taken, risk margin is calculated by calculating first the provision as a whole, identifying within that uncertain number another uncertain number, namely best estimate, which leads to an amount that has little meaning. We are concerned that CEIOPS has a mistaken impression that all actuaries / accountants would be able to identify a singular figure as the best estimate whereas in practice actuaries can only indicate a possible range within which a best estimate might lie (and even that range cannot typically be agreed with any precision). If that information is disclosed publicly, there is a risk that it will be misinterpreted. Any requirement for such disclosure will therefore necessarily require the reporting entity to draw attention to the significant uncertainties in any such estimates which may swamp the risk margin.

4.14 Reading para. 4.16, we conclude that any bullet points other than 4 and 5 are for supervisory (private) reporting purposes only. We support that position, especially with respect to bullet point 6, since this refers to sensitive data regarding the stability of an insurer in a potentially avertable emergency situation. For example, in the UK experience has shown that this causes problems where the privately agreed solvency capital requirement may not be met. Supervisors are usually in a position to review that information in advance of the public to avoid damage to the insurance industry or unnecessarily to the individual company or its policyholders. Information about emergency situations require a prior discussion with the supervisor before the public is alarmed. Similar information on breaches of capital requirements is required under IAS 1 revised. It may be useful to synchronize the disclosure under IAS 1 and for supervisory reporting purposes. There is always a requirement to consider whether any such information would need to be disclosed in order to maintain orderly financial market trading in the shares of the entity.

4.19 We refer to our comment above on 4.14.

4.24 We would expect that with respect to internal model also the risk capital is required to be publicly disclosed (see para. 4.17). However, the question arises as to whether all this information needs to be made public.

5.6 First bullet point: we would expect that such information is required for supervisory reporting only.

Consultation Paper no. 20 – Pillar I issues

We set out below only comments only on Chapter 3 of the Consultation Paper. We have not given detailed consideration to other sections of this Paper.

3.17 As far as we are aware the IASB does not maintain a “position against using insurance liabilities for prudential purposes”, the Framework states the objective of financial statements is to provide information to a wide range of users making economic decision. The fact that IFRS financial statements are not specially designed for the supervisory purposes does not mean that there is a position against its use for prudential purposes.

3.18 We note that already under a historical cost approach the credit worthiness of the issuer of a financial instrument is reflected in the transaction price. The same is true (at least in wholesale reinsurance arrangements) for the premium received for insurance coverage. The key question is whether changes in the credit worthiness are to be reflected in subsequent measurement. Under normal circumstances, if full fair value principles were adopted, we would expect that change in credit standing of an insurer would allow for a revaluation of technical provision only if the impact is observable and verifiable.

3.19 We support the view that, as far as possible, solvency rules should rely on the calculation of technical provision in accordance with IFRS: Care needs to be taken also with respect to terminology, whether any solvency regulation is considered as an interpretation of IFRS or whether it is an amendment required for supervisory purposes, only. We remain inclined to the view that excessive provisions are not helpful to the understanding of the regulatory position and that additional prudence or profit margins should be included in capital.

If however a common view on exit values can be determined there is an argument that any such provision would be sufficient to meet the transferability test – except that such value would not be achievable in a break up scenario or where the credit rating of the failing entity had influenced the exit value measure. If the IASB determines that the credit rating effect of the insurer should be reflected in the value of the liability (thereby reducing the reported amount) we would understand that the difference may for regulatory purposes need to be reinstated to allow a transfer based value to be reported.

3.25 We consider the proposal to require a “conservative valuation” immediately results in a deviation from the qualitative characteristic of financial statements under IFRS (see also 3.48 and 3.121) which may, despite of the use of similar terminology, result in a further significant divergence from IFRS.

3.27 We welcome that it is recognised that financial risks may not always be hedgable in deep liquid and transparent markets.

3.28 We are not clear whether CEIOPS is suggesting that an option is given to use one or the other measurement objective or whether the Framework Directive shall prescribe one, or even the more conservative of the mentioned objectives. Our comment on paragraph 3.19 above is pertinent to this paragraph.

3.29 We support the need for an appropriate Framework that is appropriate to model as objectively as possible inputs which cannot be observed in deep and liquid markets. The extent of uncertainty and time horizon of relevant cash flows creates a special need to develop disciplined guidance in order to avoid earnings management for financial statement purposes. We believe that this is one of the major challenges for the valuation of technical provisions for supervisory and GAAP purposes.

3.30 One of the major risks in life insurance is the lapse risk which is also unlikely to be considered hedgable but may be able to be reinsured.

3.40 It would be helpful if for regulatory purposes and for IFRS the same aggregation of segments could be adopted. This should be reflected by a consistent definition. If more granular information is considered necessary for regulatory reporting we question whether that needs to be made public.

3.48/3.121 Requiring, that the most conservative edge of a range of reasonable and justifiable estimates be taken, does not comply with the neutrality requirement of an unbiased estimate under IFRS. The size of the range should be reflected in the risk margin. The paper adopts the most conservative approach of the possible estimates of value. Generally, this is likely to be an inappropriate basis for GAAP reporting.

3.55 The treatment of default risk of reinsurers needs to be revised, depending on the treatment in the general financial statements. The default risk, before the reinsurer defaults, should be taken into account in the measurement of reinsurance assets under a current exit value approach, since it would be considered by a transferee.

3.58/3.133 Discontinuance experience should not only be based on past experience, but should be consistent with all other assumptions of the scenario, including assumptions relating to discretionary surrender values.

If future advantageous policyholders’ behaviour is considered, i.e. it is possible that the technical provision is lower than the current guaranteed surrender value, it is necessary to answer the question, which risk margin is to be applied to the uncertainty inherent in policyholders’ behaviour. It can be questioned, whether past experience for human behaviour in financial actions has actually reflected similar statistical evidence as e.g. mortality experience. Furthermore, there is no market price theory regarding prices for irrational behaviour. Hence, risk margins would need to be determined on a more or less arbitrary basis. In any case, the larger the gains from considering future irrational policyholders’ behaviour are, the larger the risk associated with those behaviours should be assumed to be. Given that policyholders’ irrational behaviour might be subject to severe changes especially in stress situations, exit values or settlement values should require suitably risk margins.

3.59/3.134 It is contrary to normal financial and market theory, especially option pricing approaches, to assume that options are not executed rationally and to measure the value of the option based on past experience of execution. It is therefore necessary to investigate, to which extent irrational behaviour of counterparties can be assumed especially if this results in an asset that should be measured at a “reliable” market value. Even more critical are attempts to predict how in future irrational behaviour will react with future changes in the environment, e.g. interest rates. These points demonstrate the challenges in simulating fair values for these assets/ liabilities.

We suggest to distinguish between guarantees and options. Any guarantee results in the risk that earnings do not cover expenses to meet obligations. Special difficulties arise if guarantees are combined with options, in a way that the burden of those obligations changes in response to external factors, namely if there are combined with a right of the counterparty to choose unilaterally between two alternatives. It may be argued that for supervisory purposes it needs to be assumed that the counterparty will choose always that alternative which turns out to be most valuable.

3.60 It is difficult to follow the guidance for management actions. It is not clear how CEIOPS addresses the relation between the notion of settlement value and the notion of fair value. Asset allocations should not impact the measurement, since risk-free discount rates are used. Product changes are not affecting current business, since existing contracts cannot be changed. If the insurer can change contracts, that right needs to be considered based on those circumstances allowing such changes. It should be assumed that the technical provision, reflecting an exit value or settlement value, would be subject to the decisions of the new owner.

It is actually necessary to assess to which extent the insurer is actually obliged to act in a certain manner and to consider to what extent the customer relationship affects the measurement. Such intangible assets might significantly affect the value of portfolios. Such intangible assets might motivate insurers to pay more than needed to uphold the value of the intangible asset. However, if that is the motivation of management action, consideration of such expenses increases the technical provision more than necessary, since a market participant would consider as well the intangible asset in determining the price for the contracts and the customer relationship. To be consistent with IFRS, it would be helpful to consider those items, expenses as well as the intangible asset, separately from the technical provision for contractual rights and obligations. We suggest to CEIOPS to consider and discuss further the issue of bonus and gain on a contract. Guidance needs to be developed by CEIOPS which can be used in all jurisdictions.

3.61-70/3.135 It appears that the Consultation Paper uses the term “discretion” as synonym for “participation” and than draw the consequences assuming that all participation benefits are discretionary or subject to national concepts like “reasonable policyholders’ expectations”. The discussion does not reflect a suitable understanding of the economics and the legal nature of performance-linked benefits in many European jurisdictions. In many jurisdictions, that part of participating benefits subject to insurer’s discretion is minor compared to the overall participating benefits (e.g. Germany). In opposite, there is a strict obligation to forward specified parts of surplus to policyholders. In other jurisdictions, there is no obligatory connection between additional benefits and surplus (e.g. Belgium). Additional benefits are paid based on considerations of the insurer, to uphold persistency or to attract new business based on own discretion. Furthermore there might be non compelling obligations like “policyholders’ reasonable expectations” to provide certain amounts, which are not subject to performance, but similar to guaranteed amounts. In other jurisdictions, the legal concept of “policyholders’ reasonable expectation” might be entirely strange since all rights and obligations are to be based on written contract guidance. The economic nature of those different types of features is so different, that it is misleading to use one common label, “participating business” for both. We propose to distinguish benefits, predominantly obligatory depending on the performance of the insurer, from discretionary benefits.

In our opinion, the conclusions drawn do not cover the different issues in different jurisdictions in an appropriate manner. Therefore, we recommend studying the issue of performance-linked benefits and discretionary benefits separately and in depth, considering carefully the main different forms found in Europe. The experience, especially in the discussions at the IASB, showed that the approach found suitable for one country is not necessarily a suitable model in another. For example the reference in other parts of the Paper (namely 5.65 or 6.506) to the ability to change future bonus rates is only relevant in a few jurisdictions, since in other jurisdictions bonus rates are simply the way to distribute among individual policyholders an amount legally reserved for participation and therefore entirely determined by that amount. The IASB correctly identified that the actual allocation to individual policyholders does not really have substantial relevance for the owner of the business. Furthermore, the Paper’s focus is entirely on policyholders’ share in investment income, while in many European jurisdictions policyholders share as well (and in case of e.g. term life policies pre-dominantly) in other risks like mortality, lapse or contract servicing.

Performance-linked benefits, with the extreme case of unit-linked benefits or insurance at cost, and performance-triggered premium adjustment clauses reduce the risk of the insurer. Shares of policyholders in future, i.e. not yet recognized surplus is not an obligation today and should therefore not be considered in the estimated mean value of future discounted cash flows. Any surplus reported, should be adequately split between entity's share and policyholders' share. As far as the entity's share is subject to deviation risk (uncertainty) a risk margin should be determined on that share, not on the entire cash flows belonging mainly to policyholders. A risk margin is the price of the owner of the entity for bearing deviation risk, not a margin on uncertainties in general of cash inflows and outflows within one unit of account, if the uncertainties are re-transferred to the counterparty. For all performance-linked benefits, including performance-linked forms of unit-linked and investment-linked contracts as well as all performance-linked participating contracts, benefits linked to future performance are not considered within the estimated mean value of future discounted cash flows but determined based on the currently recognized performance.

Discretionary benefits are sometimes formally connected with surplus (e.g. in Belgium) while the amount is nevertheless entirely at the discretion of the insurer, but often contractual stipulations about those benefits do not provide any reference to surplus at all (universal-life contracts) or they are entirely voluntary (ex gratia payments), i.e. there is no reference in contracts to those benefits (e.g. bonuses paid voluntarily on top of prescribed shares in surplus in some countries with strict rules for policyholders sharing in surplus). It is necessary to investigate first, whether there isn't a hidden obligation to pay those benefits, e.g. if "policyholders' reasonable expectations" cause in the relevant jurisdiction an enforceable claim or if it is expected that authorities would intervene if the amounts are not paid although that was never observed before since entities paid under anticipatory obedience voluntarily. Further, any constraint of discretion needs to be investigated. If there is not actually discretion, the payments should not be classified as such but as guarantees or performance-linked benefits, depending whether the obligation is independent or dependent on surplus. If the payments are actually at the discretion of the insurer, it is necessary to investigate for what economic purpose they are paid. Normally, a profit-oriented enterprise would not pay voluntary amounts without good economic reason. Main reasons will be to avoid lapses and to attract new business. If for example contracts turn out to be deficient and the insurer is closed for new business, there is not longer any motivation to pay such discretionary benefits. Those considerations are needed to identify the economic nature and function of such benefits and to decide their impact to the overall risk situation of the insurer.

Considering that in many European countries participating contracts are the majority if not nearly all life insurance contracts, and that the specific features shape the economic nature of the contracts and the risk position, the issue is very important and should be considered more extensively.

3.71 The guidance is misleading. It should clarify, that the unit-linked obligation itself should be measured – like any other performance-linked obligation – consistently with the linked performance, i.e. the fair value of linked units. Any other cash flow under the contract, which is not performance-linked, is measured like any other guaranteed or discretionary benefit. However, special care is needed in measuring cash flows which are indexed with the development of the units, e.g. death benefits in excess of the fund value depending on the fund value, where there is a minimum guaranteed death benefit and charges for expenses. It is not sufficient to measure index-linked benefits simply based on one "most likely" scenario of the fund. They should be measured considering all possible scenarios of fund development applying market consistent information.

3.82-85/3.122 It is necessary to consider, that the Cost of Capital approach, although a reasonable approach in many practical cases, is not by nature reflecting the risk price of market participants for uncertainties in cash flows arising from the insurance contracts. Like a percentile, it reflects a one point view, here the estimated required capital. Market participants do not identify the variety of possible advantageous and disadvantageous outcomes with just the capital required to cover certain adverse results. They take into account both potential advantageous outcomes reducing the risk price and losses in excess of the capital as well, increasing the risk margin. If the estimated required capital is defined as the SCR the result may be circular, since capital and risk margin are to some extent interrelated. Furthermore, we would expect that the cost of economic capital – rather than regulatory capital (3.84) – would be the preferred basis for risk management purposes. While the capital considered reflects the peculiarities of the risk to be measured it is not based on observed market prices. Hence the cost of the capital reflects market prices which are not specific for the risk to be measured. Therefore, the Cost of Capital approach might be often suitable, but the appropriateness should be reviewed in each individual case.

3.114 and 3.115 We wonder how the measurement objective “transfer value” can be combined with the aim that technical provision represent the amount that is required for an insurer to settle insurance liabilities to policyholders and other beneficiaries.

We believe that the measurement objective for solvency purposes should be a realistic view regarding the possibility of a transfer, rather than a theoretical, more comparability oriented view as it is followed for general purpose financial statements under IFRS. Portfolios to be transferred often do not qualify for merging with existing portfolios of the transferee and the cost connected with migrating the business to another insurer in its own systems are often significant. Therefore, we believe that the more realistic view may result in a difference between IFRS measurement following a current exit value measurement attribute and the measurement of technical provision for solvency purposes.

3.123 The use of the term “market value margin” is confusing, since the term “risk margin” is used in other parts of the Paper. Regulatory guidance regarding a risk margin would normally cause the risk margin for solvency purposes to deviate from the risk margin for IFRS purposes. But that appears unavoidable. The guidance for risk margins under IFRS has to emphasize merely the neutrality. In absence of dialogue between recipient of the report and the provider robust guidance is needed to achieve a reliable position. The guidance for risk margins under solvency makes use of the dialogue between authorities, the recipient of the report, and the entity to figure out the most appropriate risk margin, and can therefore be less strict, but overall the focus is on conservatism. We understand that this is reflected in para.3.109.

3.127 It is important to clarify what overhead means. Overhead cost needs to be distinguished between portfolio overhead cost needed to manage the portfolio from the variable cost per contract and the entity overhead costs which are needed to manage the entity in excess of the portfolio related overheads. If the unit of account is the portfolio, the portfolio overhead costs are clearly part of the exit value, since they will occur as well for any transferee. Within the technical provisions, entity overhead is not a reasonable item to include in determining an exit value. A transferee would not have those additional costs, but the transferred portfolio may reduce the burden of covering existing overhead. For the settlement value, the entity overhead needs to be considered additionally. It is recommended, to distinguish both measurements. The difference will be identifiable and can be reported separately. That enhances understanding of the difference, especially the difference to the IFRS exit value. Consideration should be given to reporting the related technical provisions separately.

Both, economy of scales and portfolio overhead should be considered based on the actual size of the portfolio to be measured. No guidance is provided regarding risk margins, which would be usually required by market participants for accepting the risks inherent in the obligation to service the portfolio. Such margins, referred to as service margins by the IASB, are needed to reflect adequately exit values or settlement values. The risk inherent in servicing such contracts, often for decades at guaranteed rates, is in many cases significant. There is normally no market information on how such prices are to be determined.