Federation of European Accountants
Fédération des Experts comptables Européens

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Mr. Carlos Montalvo Rebuelta
Secretary General
CEIOPS
Westhafen Tower
Westhafenplatz 1
D-60327 Frankfurt Am Main

Ref.: *CEIOPS-CP-27-09*

Our Ref.: INS/HvD/LF/SR

Dear Mr. Montalvo Rebuelta,

Re.: FEE Comments to CEIOPS on Consultation Paper No. 27 Draft CEIOPS' Advice for Level 2 Implementing Measures on Solvency II: Technical Provisions - Lines of business on the basis of which (re)insurance obligations are to be segmented

(1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the CEIOPS Consultation Paper No. 27 Draft CEIOPS' Advice for Level 2 Implementing Measures on Solvency II: Technical Provisions - Lines of business on the basis of which (re)insurance obligations are to be segmented ("the Paper").

General comments

(2) The proposed advice as described in Paragraph 3.3, is intended to provide guidance for the grouping of contracts to derive statistical information from past business to be used for future business (statistical segmentation) or grouping of contracts with virtually identical peculiarities from a measurement perspective, i.e. the same measurement assumptions, can be used for all those contracts within the group (assumption segmentation). We recommend this description of the purpose of segmentation is brought forward to Paragraph 1.2.

(3) Further issues that arise for accounting purposes include (i) to what extent contracts can be considered together in one unit of account to offset the recognition of a loss for an onerous contract with expected gains of profitable contracts (off-setting segmentation) and (ii) to what extent administrative costs are considered variable under a restricted definition of unit of account since some costs may be considered overhead or fixed. In the case of a broader definition, the same costs can be attributable and considered variable to that unit of account. We believe that these issues should be addressed as well in this or other future papers. We understand that the consideration of intra-portfolio pooling or diversification effects in measuring the risk margin is scoped out in Paragraph 3.2 of the Paper.

(4) We query the appropriateness of permitting (with rare exceptions) the use of a different segmentation for estimating the mean value of cash flows and for estimating the measure of the deviation risk from that estimated mean, i.e. the risk margin. The recently published IAA Risk Margin Paper states in chapter 6.2 that it is desirable, when determining the risk margin, to "use assumptions consistent with those used in the determination of the corresponding current estimates". Estimating the mean value of cash flows and of the risk margin for the deviation risk from that estimate should have the same statistical basis.

(5) Grouping of contracts is made for presentation or disclosure, i.e. determining the lowest level of details of published information about different contract types (= presentation segmentation). This seems to be addressed by Paragraph 3.1.5b of the Paper. However, other parts of the Paper are unclear, that this is within the intended scope of the Paper.

Detailed comments

(6) In order to first address the principle purpose, followed by the exemptions, the order of Paragraphs 3.1 and 3.3 should be changed.

(7) In our opinion regarding Paragraph 3.1, the segmentation does not necessarily need to be identical for all assumptions, e.g. different risks, cash flows etc. within one contract. For example, if contracts contain both mortality risk (e.g. during the deferment period) and longevity risk (during the annuitisation phase) it would be appropriate to produce segments for determining mortality risk grouping those contracts with mortality risk (e.g. including term life insurance without any longevity risk), while grouping for assumptions of longevity those contracts with longevity risk (e.g. including immediate annuities without any mortality risk).

(8) The Paper covers only the measurement of technical provisions. Accordingly, it is unclear why Paragraph 3.1 refers to capital requirements.

(9) Since the purpose of the Paper is to achieve proper assumptions which are relevant for grouped contracts (segment) to be measured, the assumptions need to be derived from past business which is sufficiently similar to those to be measured to provide relevant information. This approach is applicable to all companies. It would be helpful if this could be elaborated in Paragraph 3.3.

(10) In relation to Paragraphs 3.4 to 3.7, we doubt, whether the approaches should be different for life and non-life liabilities. Although there are present value techniques applied to measure life insurance technical provisions, the assumptions used for insurance risk, especially mortality and morbidity, are derived by similar statistical techniques as described in Paragraph 3.5 of the Paper. In most life insurance contracts insurance risk is less relevant than in most non-life contracts. However, this should not result in creating a deviation from a principle-based approach. The last sentence of Paragraph 3.6 on the use of homogenous data could be used as well in Paragraph 3.5 of the Paper. There is no conceptual difference in our view.

(11) Paragraph 3.7 of the Paper addresses profit sharing business. We note that “profit sharing” is in character, function and styling so different from country to country, that a general statement in that regard or a general measurement approach may not be suitable. In some jurisdictions, collective obligations exist especially for participating business, which are created by contracts but do not belong to an individual policyholder nor to “a particular line of profit sharing business”, although ultimately separated from the entity’s fortune. It is neither possible nor reasonable to artificially associate those collective obligations to groups of individual contracts, at least not without ensuring that the sum of all those allocated amounts equals to the collective obligation. In any case such an allocation would introduce an unnecessary arbitrariness.

(12) The split in “line of business” as addressed in Paragraph 3.8 deviates from the actual main issue; to derive assumptions for specific risks, rather than for a contract in its entirety. The segmentation for statistical and assumptions choosing purposes should not be based on a classification of contracts. Statistical information should be used wherever relevant information is found. If for example, accident insurance provides mortality information (since death cases are reported, regardless whether an accident has occurred), that statistical information may provide evidence about the mortality of a special clientele, if mortality assumptions play a role in measurement of life insurance contracts without additional mortality benefit but refund of the funds in case of death.

(13) In relation to Chapters 3.1.2 and 3.1.3 we wish to observe that a classification by business lines does not provide necessarily useful statistical segments for setting proper assumptions. Those lines can be excessively wide and more refined choices of segments are needed for achieving relevant statistical information for specific cases. Alternatively, those lines cause an unreasonable burden, e.g. in case of mixed contracts, group contracts or reinsurance treaties, which are styled to produce a certain risk pattern, regardless of what the originally underlying risk was. We question if the approach is not too arbitrary and bureaucratic.

Avenue d’Auderghem 22-28 • B-1040 Brussels • Tel: +32 (0)2 285 40 85 • Fax: +32 (0)2 231 11 12 • secretariat@fee.be • www.fee.be
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(14) The advice in Chapter 3.1.5 appears to focus on presentation rather than on calculating technical provisions. As indicated before the latter segmentation should be exercised on risk level rather than on contract level.

For further information on this letter, please contact Ms. Saskia Slomp from the FEE Secretariat.

Yours sincerely,

Hans van Damme
President

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