



Ms Sandra Hack
European Insurance and Occupational
Pensions Authority (EIOPA)
Westhafenplatz 1
D-60327 Frankfurt am Main

10 January 2012

Ref.: INS/PRJ/SKU/IDS

Dear Ms Hack,

Re: Possible Solvency and Financial Condition Report components subject to assurance

- (1) FEE (the Federation of European Accountants) is pleased to provide you with its suggestions on the Solvency II Financial Condition Report ("SFCR") components that should be subject to assurance by external auditors.
- (2) The document is the outcome of our ongoing dialogue on the auditors' involvement in the Solvency II reporting as a means of enhancing the quality of public reports and to address users' expectation gaps. Many relevant points were summarised in the FEE Briefing Paper *Enhancing the Quality of Solvency II Public Reporting – Benefits of Harmonising Auditor Reporting for the Users* issued in August 2010, a copy of which was sent to EIOPA.
- (3) At our meeting with representatives of the European Commission DG Internal Markets and Services and representatives of the EIOPA Internal Governance, Supervisory Review and Reporting Expert Group on 12 July 2011, we committed to provide EIOPA with a document that included a proposed subset of the SFCR that should be subject to assurance by an independent auditor in order to address the existing expectation gaps of the users.
- (4) Now that the EIOPA public consultation¹ has been launched, we have finalised this letter and make references to concrete proposals therein. We hope you will find our suggestions convincing. We firmly believe that assurance provided on the subset suggested by us will enhance the quality of public reporting on solvency.

¹ *Draft proposal on Quantitative Reporting Templates and Draft proposal for Guidelines on Narrative Public Disclosure & Supervisory Reporting, Predefined Events and Processes for Reporting & Disclosure*

- (5) In the context of private reporting, we provided Ms Kraśniewska from EIOPA with the letter on *Role of the External Auditor vs. Role of the Insurance Supervisor* on 18 October 2011 in which we elaborated on how the provision of independent assurance on data submitted to the supervisor could assist them so that they can focus on taking relevant measures and draw conclusions about the insurance industry as a whole. We included examples of auditor's involvement and possible degrees of assurance to be provided. Thus you could find that letter helpful in the SFCR context as well.
- (6) This letter is provided solely for your internal use. We are at your disposal to discuss further and/or provide any additional information you may need in due course.

For further information on this letter, please contact Sylwia Kujawa, Project Manager from the FEE Secretariat on +32 (0) 2 285 40 86 or via email at sylwia.kujawa@fee.be.

Yours sincerely,

A handwritten signature in grey ink, appearing to read 'Philip Johnson', with a long horizontal stroke extending to the right.

Philip Johnson
President

Possible Solvency and Financial Condition Report components subject to assurance

(1) FEE identified the subset that should be subject to providing assurance by an independent auditor as:

- Solvency II balance sheet;
- Own funds;
- Variance analysis, explaining all changes in basic own funds;

The variance analysis is not equivalent to a profit and loss account and it is not intended to include it in the SFCR. Nevertheless, we would include it in the audited subset because relational testing - the reconciliation between the opening balance and closing balance sheet - is an important audit procedure as it gives assurance over accuracy and completeness of the closing balance sheet (e.g. the development in basic own funds during a reporting period).

- Statement of available solvency;
- Solvency Capital Requirement;
- Minimum Capital Requirement;
- Risk paragraph;
- Explanatory notes on the basis for estimation, parameters and assumptions used, and estimation uncertainty, as well as the differences between the Solvency II balance sheet and the financial statement balance sheet.
- Sufficient qualitative and quantitative information to create understanding as regards (movements in) the various assets, insurance liabilities and other liabilities.

Assurance can be provided on both “solo” and group level.

The above suggestions are based on the thorough analysis of the EIOPA draft proposal on Quantitative Reporting Templates as well as the draft proposal for Guidelines on Narrative Public Disclosure & Supervisory Reporting as developed by EIOPA.

- (2) The selection of this subset is determined by whether reasonable assurance can be provided without undue cost, such that the benefit to users exceeds the cost. In addition to the nature of the financial information (historical vs. future oriented) auditability also depends on internal controls (covering data quality aspects) over the capture and recording of the information. i.e. whether or not appropriate internal control systems are in place.
- (3) Hence, the “financial statement type” information within the SFCR was selected to be part of the subset, while the more “MD&A” or “management report” type of information has been left out; similar to financial statement audits, the role of the auditor would be restricted to report on inconsistencies in the “MD&A” type of information with the audited subset.

- (4) The SCR and supporting information was selected to be part of the subset because this information is considered crucial to the users of the SFCR and the benefits of audited information are deemed to exceed the extra audit expense. Because the presentation, measurement and disclosure requirements of the SFCR are well described, we are confident that a reasonable assurance level can be delivered.
- (5) Reasonable assurance that an auditor is able to obtain is not a generic one but rather the one reasonable in the circumstances of the individual assignment. In particular, in auditing risk and the assumptions regarding future developments, the auditor cannot obtain as high level of assurance as it is possible in respect of certain other items of historical financial information.
- (6) Participating insurance and reinsurance undertakings or insurance holding companies are required to disclose publicly information on the solvency and financial condition at the level of the group. The Directive also allows them (subject to permission of the group supervisor) to provide a single solvency and financial condition report comprising both that information and the solvency and financial condition information required in relation to any of their subsidiaries. Therefore, we assume that the audited subset is often a group SFCR and certain relevant solvency information of individual undertakings.
- (7) In the annex to this letter, the audited subset of the SCR has been linked to the individual captions of the SFCR, according to the latest insights of the quantitative reporting templates that will be attached to the SFCR and the content of the SFCR in line with the latest available level 2 text. Our analysis may be subject to change if the final level 2 and 3 regulations are modified.
- (8) The audit of the SCR and the supporting and explanatory information is of particular relevance. Our tentative view is that this information is key to users of the SFCR and that it potentially meets the requirements for delivering reasonable assurance to this information. However, the insurance industry has limited history in fully bringing this information under the discipline of control over financial reporting. We have included this information in the audited subset and we propose having further discussions on this topic.



ANNEX:

Details of the proposed SFCR subset subject to assurance

(The Quantitative Reporting Templates have been presented in *italics*)

Key information for identification purposes

Entities in the scope of the group

(a) the name and legal form of the undertaking;

(b) the name and contact details of the supervisory authority responsible for financial supervision of the undertaking and, where applicable, the name and contact details of the group supervisor of the group to which the undertaking belongs;

(c) a description of the holders of qualifying holdings in the undertaking;

(d) where the undertaking belongs to a group, details of where the undertaking sits within the legal structure of the group;

(e) the undertaking's material lines of business and material geographical areas where it writes business;

Solvency II balance sheet

Balance sheet (solo and group reporting)

Analysis of changes in basic own funds, including details on sources of earnings. A statement of sources of earnings could be presented separately.

Analysis of changes in basic own funds (solo reporting)

Statement of available solvency

Own funds (solo and group reporting)

The following information shall be disclosed by insurance and reinsurance undertakings regarding their own funds:

(b) separately for each tier, information on the structure, amount and quality of own funds at the end of the reporting period and at the end of the previous reporting period, including an analysis of the significant changes in each tier over the reporting period;

- (c) the eligible amount of own funds to cover the Solvency Capital Requirement, classified by tiers;
- (d) the eligible amount of own funds to cover the Minimum Capital Requirement, classified by tiers;
- (e) a quantitative and qualitative explanation of any material differences between equity as shown in the undertaking's financial statements and the excess of assets over liabilities as calculated for solvency purposes;
- (g) for each material item of ancillary own funds: a description of the item, the amount of the ancillary own-fund item and, where appropriate, the method by which to determine the amount of the ancillary own-fund item, as well as the nature and the names of the counterparty or group of counterparties when there are many minor parties, to the extent that such disclosure is legally possible and practicable;
- (h) a description of any item deducted from own funds and of any significant restriction affecting the availability and transferability of own funds within the undertaking.

Solvency Capital Requirement

Solvency Capital Requirement (solo and group reporting)

(Re)insurance solo requirements (group reporting)

Non-(re) insurance solo requirements (group reporting)

The following information shall be disclosed by insurance and reinsurance undertakings regarding their Solvency Capital Requirement and their Minimum Capital Requirement:

- (a) the amounts of the undertaking's Solvency Capital Requirement and the Minimum Capital Requirement at the end of the reporting period, together with an indication that the final amount of the Solvency Capital Requirement is still subject to supervisory assessment;
- (b) the amount of the undertaking's Solvency Capital Requirement split by risk modules where the undertaking applies the standard formula, and by risk categories where the undertaking applies an internal model;
- (c) information on whether and for which risks the undertaking is using simplified calculations or undertaking specific parameters pursuant to Article 104(7) of Directive 2009/138/EC, in the standard formula or a partial or a full internal model;
- (d) unless the undertaking's Member State has made use of the option provided for in the third subparagraph of Article 51 (2) of Directive 2009/138/EC, the impact of any undertaking-specific parameters used by the undertaking in applying the standard formula in accordance with Article 110 of Directive 2009/138/EC and the amount of any capital add-on applied to the Solvency Capital Requirement, together with concise information on its justification by the supervisory authority concerned;

(f) any material change in the Solvency Capital Requirement and in the Minimum Capital Requirement over the reporting period, and the reasons for any material change.

Minimum Capital Requirement

Minimum Capital Requirement (solo reporting)

See details above for SCR and MCR information.

Risk paragraph

Insurance and reinsurance undertakings shall disclose qualitative and *quantitative* information regarding their risk profile, separately for the following categories of risk:

- (a) underwriting risk;
- (b) market risk;
- (c) credit risk;
- (d) liquidity risk;
- (e) operational risk;
- (f) other material risks.

With regard to risk concentration, insurance and reinsurance undertakings shall disclose a description of the material risk concentrations to which the undertaking is exposed.

With regard to risk sensitivity insurance and reinsurance undertakings shall disclose a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events.

Risk concentration – general (group reporting)

Explanatory notes on the basis for estimation, parameters and assumptions used, and estimation uncertainty, as well as the differences between the Solvency II balance sheet and the financial statement balance sheet.

The following information shall be disclosed by insurance and reinsurance undertakings regarding the valuation of

their assets for solvency purposes:

(a) separately for each material class of assets, the amount of the assets, as well as a description of the basis, methods and main assumptions used for valuation for solvency purposes;

(b) separately for each material class of assets, a quantitative and qualitative explanation of any material differences between the basis, methods and main assumptions used by the undertaking for solvency purposes and those used for their valuation in financial statements.

The following information shall be disclosed by insurance and reinsurance undertakings regarding the valuation of their technical provisions for solvency purposes:

(a) separately for each material line of business the amount of technical provisions, including the amount of the best estimate and the risk margin, as well as a description of the basis, methods and main assumptions used for their valuation for solvency purposes;

(b) a description of the level of uncertainty associated with the amount of technical provisions;

(c) separately for each material line of business, a quantitative and qualitative explanation of any material differences between the basis, methods and main assumptions used by the undertaking for solvency purposes and those used for their valuation in financial statements.

(d) where applicable, information on whether the insurance or reinsurance undertaking is using the transitional provisions on the risk-free interest rate term structure referred to in Article IR8 and [the quantitative impact on the valuation of technical provisions where those transitional provisions are used];

(e) a description of:

(i) the relevant assumptions about future management actions,

(ii) the relevant assumptions about policy holder behaviour,

(iii) the recoverables from reinsurance contracts and special purpose vehicles,

(iv) the illiquidity premium corresponding to the insurance and reinsurance obligations,

(v) any material changes in the relevant assumptions made in the calculation of technical provisions compared to the previous reporting period.

The following information shall be disclosed by insurance and reinsurance undertakings regarding the valuation of their other liabilities for solvency purposes:

(a) separately for each material class of other liabilities the amount of other liabilities as well as a description of the basis, methods and main assumptions used for their valuation for solvency purposes;

(b) separately for each material class of other liabilities, a quantitative and qualitative explanation of any material differences with the valuation basis, methods and main assumptions used by the undertaking for solvency purposes and those used for their valuation in financial statements.

Insurance and reinsurance undertakings shall include appropriate information on the areas set out in Article 254 (1) [x2 IM3] in complying with their supervisory reporting and public disclosure requirements.

Insurance and reinsurance undertakings shall disclose in a separate section any other material information regarding the valuation of assets and liabilities for solvency purposes.

Sufficient qualitative and quantitative information to create understanding as regards the (movements in) the various assets, insurance liabilities and other liabilities.

Off-balance sheet items (solo reporting)

Premiums, claims and expenses (solo reporting)

Life and health SLT technical provisions (solo reporting)

Non-life technical provisions (solo reporting)

Contribution to group SCR with D & A (group reporting)

IGT derivatives (group reporting)

The following information shall be disclosed by insurance and reinsurance undertakings regarding the option set out in Article 304 of Directive 2009/138/EC:

(a) an indication that the undertaking is using the duration-based equity risk sub-module set out in that Article for the calculation of its Solvency Capital Requirement, after approval from its supervisory authority;

(b) the amount of the capital requirement for the duration-based equity risk sub-module resulting from such use.

The following information shall be disclosed in addition to any other information related to that internal model which is already reported in any other part of the solvency and financial condition report, by insurance and reinsurance undertakings where an internal model used to calculate their Solvency Capital Requirement:

(c) where a partial internal model is used, a description of the technique which has been used to integrate any partial internal model into the standard formula including, where relevant, a description of non standardised techniques used;

(d) a description of the methods used in the internal model for the calculation of the probability distribution forecast and the Solvency Capital Requirement;

(e) an explanation - in general terms and by risk module - of the main differences in the methodologies and underlying assumptions used in the standard formula and in the internal model;

(f) the risk measure and time period used in the internal model, and where they are not the same as those set out in Article 101(3) of Directive 2009/138/EC, an explanation of why the Solvency Capital Requirement calculated using the internal model provides policy holders and beneficiaries with a level of protection equivalent to that set out in Article 101 of Directive 2009/138/EC.

(g) a description of the nature and appropriateness of the data used in the internal model.

The following information shall be disclosed by insurance and reinsurance undertakings regarding any non-compliance with their Minimum Capital Requirement or significant non-compliance with their Solvency Capital Requirement:

(a) regarding any non-compliance with the undertaking's Minimum Capital Requirement: the period and maximum amount of each non-compliance during the reporting period, an explanation of its origin and consequences, any remedial measures taken, as provided for under Article 51(1) (e) (v) of Directive 2009/138/EC and an explanation of the effects of such remedial measures;

(b) where non-compliance with the undertaking's Minimum Capital Requirement has not been subsequently resolved: the amount of the non-compliance at the reporting date;

(c) regarding any significant non-compliance with the undertaking's Solvency Capital Requirement during the reporting period as defined in Article COF 2 (3): the period and maximum amount of each significant non-compliance and, in addition to the explanation of its origin and consequences as well as any remedial measures taken, as provided for under point (e) (v) of Article 51(1) of Directive 2009/138/EC, an explanation of the effects of such remedial measures;

(d) where a significant non-compliance with the undertaking's Solvency Capital Requirement has not been subsequently resolved: the amount of the non-compliance at the reporting date.