Federation of European Accountants
Fédération des Experts comptables Européens

10 June 2009

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

Ref.: *CEIOPS-CP-31-09*

Our Ref.: INS/HvD/LF/SR

Dear Mr. Montalvo Rebuelta,

Re: FEE Comments to CEIOPS on Consultation Paper No. 31 Draft CEIOPS' Advice for Level 2 Implementing Measures on Solvency II: SCR standard formula – Allowance of financial Mitigation Techniques

(1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the CEIOPS Consultation Paper No. 31 Draft CEIOPS' Advice for Level 2 Implementing Measures on Solvency II: SCR standard formula – Allowance of financial Mitigation Techniques ("the Paper").

General comments

(2) We agree that financial mitigation techniques should be embedded in both the SCR standard formula and internal models and that the credit risk related to the instruments used in the mitigation techniques should be evaluated in the credit risk module.

(3) The consultation paper only addresses the qualitative elements of risk mitigation. While we believe that the CEIOPS 's advice will contribute to the quality of the undertaking's organisation where risk mitigation techniques are applied, it could be further enhanced by the following:

- A more explicit requirement for back testing and experience to assumption analyses in order to continuously monitor the effectiveness of the risk mitigation techniques in comparison to the “solvency at risk effect” according to the standard or internal model. Such analyses may also support the quality of the Pillar III disclosures on risk and risk mitigation and improve auditability.

- A clearer link to product pricing and valuation. As the distinction between hedgeable and non hedgeable components in valuation (and perhaps also pricing) becomes more and more best practice, there is an opportunity to make a clear and transparent link between the undertaking’s risk mitigation techniques and its choices therein and the “blue print” of the insurance products they develop and sell.

Detailed comments

Paragraph 3.40

(4) Paragraph 3.40 suggests that techniques like synthetic hedging are excluded from risk mitigation credits in the SCR. While we understand that such techniques do not protect against a sudden shock, the undertaking with a proper procedure for constructing synthetic hedges is better off than the undertaking that has none. In addition, there are other, contractual mitigation devices that do not give full protection in a situation of a sudden shock either. An example may be an interest rate swap where the yield curve is highly convex. We suggest to consider whether and how such partial mitigations can be included.

Paragraph 3.43

(5) Paragraph 3.43 indicates that the undertaking should demonstrate that the basis risk is not material to the mitigation effect. We are not sure what the basis risk is and would recommend clarifying this point. In addition, we suggest that proper back testing and experience to assumption may support the undertaking’s analysis at this point.

Paragraph 3.55

(6) Paragraph 3.55 discusses the degree of correlation between the credit quality of the risk mitigating instrument and the “kicking in” of the instrument. We would recommend giving more guidance on the unit of account. In addition, the question is raised whether this should be evaluated for each instrument / counter party separately or for a portfolio of instruments.

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Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

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

Yours sincerely,

Hans van Damme
President