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Dr Thomas STEFFEN
Bafin
Graurheindorfer Strasse 108
DE – 53117 Bonn

Subject: Solvency II – QIS4 Call for Advice

Dear Thomas,

Following the consultation on the fourth Quantitative Impact Study (QIS4), please find attached a Call for Advice asking CEIOPS to run QIS4. The Call for Advice requests CEIOPS to run the exercise between April and July 2008 and publish a report on the results of that exercise in November 2008 in the frame of the development of potential future level 2 implementing measures for the Solvency II Directive Proposal.

I would like to take this opportunity to thank CEIOPS for its excellent technical support during the consultation, and in particular for its invaluable help in processing the comments received from stakeholders on the draft technical specifications. The on-line consultation ran from 21 December 2007 to 15 February 2008 during which time a Public Hearing was held on 28 January 2008 and a meeting with Member States was organised on 1 February 2008. In total over 1600 comments were received.

We will publish the Call for Advice and the specifications on our web-site along with a summary feedback statement and an excel table containing all the comments received along with an indication as to whether the comment was taken on board or not.

QIS4 Technical Specifications

The key changes made to the specifications in response to the issues raised during the consultation are set out below.

MCR – A combined approach will be tested for the MCR calculation in QIS4 – i.e. CEIOPS linear approach combined with a cap of 50% and a floor of 20% of the SCR (whether calculated using the standard formula or an internal model) – in order to ensure a proper ladder of supervisory intervention.

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Commission européenne, B-1049 Bruxelles / Europese Commissie, B-1049 Brussel - Belgium. Telephone: (32-2) 299 11 11. Office: SPA2 02/033. Telephone: direct line (32-2) 295 97 60. Fax: (32-2) 299 30 75.

http://ec.europa.eu/internal_market/

E-mail: benedict.carr@ec.europa.eu

Equities – In addition to the default approach in QIS4 (32% shock for listed and 45% shock for non-listed equities plus 0% correlation between equity and interest rate risk) an equity dampener approach proposed by the French Trésor and the French industry will be tested which is designed to reduce potential pro-cyclical effects.

Deferred taxes – An economic approach to deferred taxes will be taken in QIS4. In other words all expected future cash-out and cash-in flows will be recognised in the solvency balance sheet including those related to taxes, but the risk absorbing capacity of those cash-flows will also be taken into account in the determination of the SCR.

Future premiums in technical provisions – The wording regarding the inclusion of future premiums in technical provisions has been modified to bring it in to line with suggestions made by the CFO Forum. This wording replaces three criteria used to determine whether future premiums from existing contracts can or cannot be included in the best estimate of technical provisions, which come from the IASB discussion paper on insurance contracts.

Determination of the risk-free interest rate – As was the case for QIS2 and QIS3 swap rates rather than government bond rates will be used for the purposes of determining the risk-free interest rate term structure in QIS4. Swap curves were retained for QIS4 as they are widely used in financial markets to present value future cash-flows.

Hybrid capital instruments – The wording regarding the classification of hybrid capital instruments has been adjusted in order to ensure these instruments receive an appropriate treatment and to address concerns raised about the potential impact on the marketability of innovative capital instruments. In particular, changes have been made to the assessment of the appropriateness of step-up features.

Participations – A reduced (16% rather than 32% and 22.5% rather than 45%) equity stress will be tested in QIS4 for insurance and non-insurance participations in the solo SCR calculation along with an across the board standard equity stress for all participations. Insurers will also on an optional basis be able to provide figures on a look-through basis – i.e. participations should be treated in the solo SCR and group SCR calculations in the same way.

Calibration of the non-life underwriting risk and use of entity specific data – The option to use entity specific parameters has been expanded to cover reserve risk as well as premium risk in the SCR standard formula. This should not only improve the accuracy of the results of QIS4, but also allow for more data to be collected which can be used to refine the calibration of the standard formula for non-life underwriting risk.

Groups – The group specifications have been re-worked in line with comments received from the ABI and other industry bodies which are designed to make the specifications clearer and more straightforward to follow. In particular, they make clear that the default method is the worldwide accounting consolidation method which applies the SCR calculation to the group as if it were a single entity.

CEIOPS additional advice

In addition, to the changes made above in response to comments received during the consultation, two changes have been made to the QIS4 specifications in response to the current financial turmoil at CEIOPS request.

Structured credit products – First, higher stresses will be applied in the credit spread risk module to structured credit products than to vanilla bonds. These stresses are broadly aligned with the charges applicable under the Capital Requirements Directive.

Equity-interest rate correlations – Second, information will be collected on how sensitive the SCR calculation is to the assumptions made about the extent to which equity price changes are correlated with movements in interest rates. To this end, the impact of using a +0.25 correlation between a fall in equities and a downward movement in interest rates, along with -0.25 correlation with an upward movement in interest rates will be assessed.

Call for Advice

The two changes made to the Call for Advice in response to the issues raised during the consultation are set out below.

Transparency of the calibration process – One of the objectives set out in the Call for Advice for QIS4 is that it should be used to check that the specifications tested are aligned with the principles and calibration target set out in the level 1 Framework Directive Proposal. Industry representatives asked CEIOPS to disclose as much information as possible on calibration of the QIS4 technical specifications. CEIOPS published a background document on calibration of the SCR and MCR during the consultation which explains the analysis behind the calculation of some of the parameters that have changed since QIS3.

In the updated version of the Call for Advice, Commission Services have introduced a paragraph which makes clear that the analysis performed for the purposes of the QIS4 report regarding the appropriateness of the QIS4 calibration should explicitly refer back to the analysis performed and the paper produced for QIS3, in the case of parameters that have not changed, or to the latest background document on calibration of the SCR and MCR, in the case of those that have.

National guidance – The question as to whether the QIS4 technical specifications could be supplemented with additional national guidance produced by supervisory authorities was raised during the QIS4 Public Hearing. CEIOPS emphasised that national guidance would facilitate a high participation of undertakings in the exercise; whereas, some industry representatives argued for little or no guidance at national level, as it could undermine the comparability of results and jeopardize the objective of introducing a European harmonized standard for Solvency II.

In response in the Call for Advice, Commission Services have introduced a paragraph, allowing for national guidance to be provided where it is deemed necessary in order to facilitate a high participation in the exercise, with the proviso that any additional guidance will have to be translated in English and published on CEIOPS website. The publication of the guidance will ensure that the process is transparent and the results of QIS4 are comparable.

Participation in QIS4

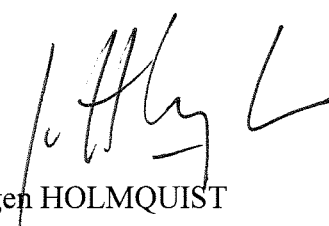
I would also like to draw your attention to another change that the Commission has made to the QIS4 technical specifications, which is designed to boost participation. Namely, to increase the percentage of business for which simplified SCR calculations can be used, in

line with comments received from AMICE. This reflects the importance we attach to ensuring high participation in QIS4 both at solo and group level. It is worth noting that the European Parliament also believes that a high level of participation in QIS4 is vital.

On this point, I would also like to strongly support CEIOPS efforts to ensure that the QIS4 spreadsheets, which I am aware you have already started working upon, are as user friendly as possible and in particular that they do not overburden small and medium-sized undertakings. I would also like to thank CEIOPS for the paper they have produced on the processing of groups results at EU level, which should address any residual concerns groups may have had about ensuring that confidential information submitted to the centralised database would be securely transmitted and stored.

Thank you once again for all CEIOPS hard work and support on this important European project.

Yours sincerely



Jörgen HOLMQUIST

Cc: Ms Pervenche Berès, Chairwoman ECON, European Parliament
Peter Skinner, European Parliament, Rapporteur on Solvency II
Juri Gorissek, European Council, Slovenian Presidency