QIS5 Consultation Feedback: Practicability Issues

Introduction

The CRO Forum and CFO Forum are pleased to be able to provide comment on the QIS5 draft specification, as prescribed in the QIS5 consultation. We welcome the openness to cooperation between us and trust that this is merely a point in our continuous dialogue.

We note the marked improvements evidenced in the European Commission's draft QIS5 specifications, compared to the final advice for Level 2. We are most welcoming of:

(I)   The recognition of 'in-force cash flows', or what CEIOPS terms as "expected future profits", as Tier 1 capital. A departure from the economic total balance sheet approach to define eligible own funds could have an impact in excess of €100 bn for the European Industry. Therefore, we welcome the classification of the excess of assets over liabilities in Tier 1.

(II)   A wider application of the illiquidity premium to insurers' liabilities than a binary approach. The Commission is moving in the right direction. The Industry has provided a practical framework for the application of Liquidity Premium to the liabilities to be tested in QIS5.

(III)   The allowance for diversification within the Risk Margin, where we welcome the definition of reference entity as set out in the QIS5 specifications, which allows diversification between lines of business within one entity and between entities at group level.

(IV)   The calibration of the "global" equity shock of 39% and the symmetric adjustment mechanism calibrated over a 3 year period.

Nevertheless, the CRO Forum and CFO Forum still believe that the draft specifications are too conservative and need improvement in a number of areas. In addition to our 'high-level issues paper', this document sets all our **practicability issues** in relation to the QIS 5 draft specification that list more detailed observations on the clarity of drafting.

We have also prepared separate short memos to cover technical issues raised during the QIS5 stakeholder's meeting on 30th April. We reiterate that the CRO Forum is currently conducting a pre-QIS5 exercise (11 major members agreed to participate in this survey). Results will be presented by early June to the Commission.

We would like to thank you for the opportunity to comment on the QIS5 draft specification, and we would like to offer resources to work together with CEIOPS and the European Commission in the coming weeks to help fine-tune the specifications in advance of QIS5.

Detailed Comments

The table lists all our detailed comments (high-level and practicability issues). Where appropriate a suggested mark-up to the text is provided for the issue described.

Issue#	Reference	Description
	Ref: V.12	**Valuation: Mark-to-model /Use of market/observable data** We do agree that the use of mark to model shall maximise the use of the relevant observable inputs and minimise the use of unobservable inputs and that the main objective remains, to determine the amount at which the assets and the liabilities could be exchanged between knowledgeable willing parties in an arm's length transaction (an economic value acc. To Art. 75 of the framework directive). We believe however that, in addition situations where there is no market or dislocated markets may lead to the need to more use of judgement.
	Mark-up	As a point of emphasis the second sentence in V.12.ii could be rephrased as follows: "Undertakings will maximise the use of relevant observable inputs and minimise the use of unobservable inputs, taking into account expert judgement where appropriate."
	Ref: V.1.5	**Intangible assets** QIS 5 refers to IAS 38. However, IAS 38 explicitly excludes intangible assets arising from insurance contracts. Clarification of the treatment of intangible assets in QIS 5 is required. In particular we highlight that treatment between the balance sheet and the SCR calculation should be consistent to avoid double counting of the associate risk in the solvency assessment. Paragraph SCR.4.2, page 160 indicates that the Level 1 Directive Article 75 allows intangible assets to be taken into account at their fair value.
	Mark-up	Add to V.1.5, 2nd row, 5th Col – pg12. "The scope of assets considered as intangibles should be in line with IAS 38 and exclude intangible assets arising from insurance contracts, financial assets, deferred tax assets, employee benefits, goodwill, lease assets etc."
	Ref: V.1.5	**Financial Liabilities** (eighth page of table in sub-section V.1.5) In general we agree that own credit risk should not be reflected in the valuation of liabilities after initial measurement. To avoid doubt, the QIS5 guidance should make clear that the own credit standing of a financial liability is the risk pertaining to the credit worthiness of the insurance undertaking, and not the credit quality of any security or collateral which the holder of the instrument may have recourse to. The credit risk pertaining to a particular financial liability incorporates the credit quality of any security and collateral given, as well as the creditworthiness of the insurer. In some cases, for example under secured non-recourse loans issued by a securitisation vehicle which an insurance undertaking consolidates as it retains the residual equity, the credit risk of a financial liability could be completely independent of the reporting insurance undertaking's credit worthiness. In such a scenario the assets which the counterparty to the financial liability have recourse will be held at their economic value reflecting credit risk, therefore it is appropriate that the financial liability should do so as well, to the extent this is independent of the insurance undertakings own credit worthiness
	Mark-up	
	Ref: V.1.5	**Employee benefits** Drafting is unclear with regard to the elimination of the smoothing corridor in IAS 19. Clarification is required as to whether this is CEIOPS recommendation or a specific requirement which is to be tested in QIS 5. If this is a requirement it would be onerous to apply in practice and appropriate transitional provisions would be necessary.
	Mark-up	Elimination of smoothing corridor should not be a requirement for testing in the QIS5 exercise because: a) It is not practical to test such a provision in practice.

Issue#	Reference	Description
		Drafting suggestion: "Considering the complex task of preparing separate valuation rules on pension liabilities and from a cost benefit perspective, CEIOPS recommends the application of the applicable IFRS on post-employment benefits. ~~CEIOPS considers that elimination of smoothing (corridor) is required to prohibit undertakings coming out with different results based on the treatment selected for actuarial gains and losses~~. CEIOPS believes that undertakings shall not be prevented from using their internal economic models for post-employment benefits calculation, provided the models are based on Solvency II valuation principles applied to insurance liabilities, taking into account the specificities of post employment benefits. When using an Internal Model for the valuation of items following under IAS 19 documentation shall be provided by the undertaking."
	Ref: QV.4 & V.19	**Balance Sheet Reconciliation** This requires a full reconciliation between statutory accounting values and Solvency II economic values. We understand that at solo level, statutory accounting means local accounting and that at Group level, this would refer to the principles applied by the Group, them being IFRS in many cases. This would mean that for non European entities, only reconciliation with Group applied accounting principles would apply. We also note that the directive (Art 51(2) requires " [..] an explanation of any major differences in relation to the value of such elements in financial statements .." as opposed to detailed reconciliations. For the purpose of QIS5, we would encourage CEIOPS to take a pragmatic approach is requesting such detailed reconciliations for QIS5 purposes and give due regards to the principle of proportionality
	Mark-up	V.19. "Undertakings shall have a clear picture and reconcile the **major** differences from the usage of figures for QIS 5 and figures for general purpose accounting. …" QV4 (3rd Bullet) – "~~Full~~ Reconciliation **of any major differences** from accounting values used in the statuary accounts and Solvency II economic values has to be provided."
H9	Ref: TP 1.19	**Segmentation of life business** The QIS 5 draft is not in line with how insurers manage their business. Lines of business tend to change over time with product innovation and changing policyholder demands. We would like to see some flexibility around groupings, as the current drafting does not reflect the way we manage our business. The proposal should enforce companies to be aligned at least with the high level segmentation (4 types) but allow some flexibility for the sub-types.
	Mark-up	The proposal should enforce companies to be aligned at least with the high level segmentation (4 types) but allow some flexibility for the sub-types.
	Ref: TP 1.19	**Segmentation of TP - Practical issue** This section suggests that the purpose of segmentation is to achieve an accurate valuation of the technical provision. The technical provision comprises of Best estimate and risk margin. However, Since the diversification is allowed within the risk margin, calculating the risk margin based on segmentation adds no value or accuracy to the calculation but present practical challenges by significantly increasing the resources and time required to compute the calculations. Therefore we suggest that the wording is clarified that the segmentation is only applicable for the best estimate. As far as the risk margin is concerned the segmentation should be about the disclosure not the calculation.
	Mark-up	All references to the technical provisions should be changed to best estimate where the calculation based on segmentation is required. TP.1.12. "The segmentation should be applied to <u>the best estimate</u> ~~both~~ component~~s~~ of the technical provisions ~~(best estimate and risk margin)~~." [Delete] TP.1.13.
	Ref: TP 1.35	**Segmentation of TP for cross-boarder activities** A segmentation of technical provisions by country is too onerous for large (re-)insurance groups. We propose that this clause is dropped. Any material differences by country are covered by TP 1.4 and TP

Issue#	Reference	Description
		1.9. For Non-Life and Health business a segmentation of TP into regions according to Annex K would be reasonable for companies who choose to explicitly recognize regional diversification.
	Mark-up	We propose that the clause requiring the segment of TP by country is dropped.
H3	Ref: TP.1.91.- TP.1.104.	**Boundaries of contract** We welcome the inclusion of future premiums related to in-force contracts in the computation of technical provisions. However: 1) As you are aware, we are working with European Commission staff to help clarify the intention around the contract boundary wording. 2) In addition, interactions between the cash flows to be projected out in the Solvency II balance sheet and the Solvency II requirements also require clarifications. While recognising the need for such risks to be included in the SCR, risks to be included in the new nl lapse risk module should be limited to premiums actually projected out in the technical provisions recognised in the Solvency II balance sheet.
H4	Ref: N/A	**One year of new business** The draft specification does not include any detailed guidance on the treatment of future new business in the SCR and Available Capital. We would welcome additional guidance in the specification to explain how Article 101(3) should be applied and how the same business should be included as available capital so that SCR and Available Capital are consistent in terms of scope of new business considered. In addition, we would like to ensure that the amended QIS5 technical specifications would explicitly state that this one year of new business is related to new business written in normal conditions and not in stressed conditions.
	Ref: TP.1.128	**Life insurance obligations - Practical issue** This para suggests that "As a starting point, the cash-flow projection should be based on a policy-by-policy approach … ". Allowing model points as an approximation if policy-by policy considered too onerous. > We note that the current industry practice is to use model points rather than performing the calculation on a policy-by-policy basis. To consider use of model points as an exception is inappropriate. > Model points are used with appropriate checks and balances to ensure that the results are not materially different from performing the calculations on a policy-by-policy basis. > Statements like; "[used of model points allowed if] The projection on a policy-by-policy basis would be an undue burden on the undertaking compared to the projection based on suitable model points." TP1.129(d) requires insurers to demonstrate a policy-by-policy calculation would result in "undue" burden, a very subjective exercise. Since the current industry practice is to use model points, a default requirement of calculation on a policy-by-policy basis adds additional work for firms to demonstrate that the policy-by-policy calculation creates an undue burden for them.
	Mark-up	Drafting suggestions: > Delete para - TP1.128 > Delete para - TP1.129(d)
	Ref: TP.1.326	**Future discretionary benefits – drafting issue** There is an error in this para where future discretionary benefits are quoted as Financial guarantees. Discretionary benefits are not guarantees.
	Mark-up	Remove the reference to "future discretionary benefits" as a example
H6	Ref: TP.1.326	**Liquidity Premium** We welcome the proposals on liquidity premium, which represent a significant step forward and positive evidence of the European Commission, CEIOPS and industry working together. Liquidity premium is a powerful contra-cyclical mechanism and should be applied consistently across Europe.

Issue#	Reference	Description
	TP.1.326 – 1.328	In this regard, we would like to ensure that Liquidity Premium will effectively be applicable to all liability cash flows (buckets: 0%/50%/75%/100%), The approach used by CEIOPS to extrapolate the liquidity premium is inconsistent with the illiquidity taskforce paper. The liquidity premium should be applied to the forward curve. *Please refer to the separate contribution from the Industry with a concrete and simple proposal to apply LQP to all lines of business.*
	Mark-up	P1 (100%) – full liquidity premium included • There is no option for any form of surrender or the benefits to policyholders in case of any form of surrender are less than or equal to the technical provisions determined with the portion of the illiquidity premium set at 100%. • The only significant underwriting risk connected to the contract is longevity risk and expenses. P2 (0%) – no liquidity premium included • Life insurance contracts where all investment risk is borne by the policyholder and there are no discretionary benefits. P3 (75%) – includes a 75% liquidity premium • The benefits to policyholders in case of any form of surrender are less than or equal to the technical provisions determined with the portion of the illiquidity premium set at 75%. • There are features in the liability which significantly limit the rational policyholder's behaviour in the case of any form of surrender. Examples of such features would include significant guaranteed rates or discretionary benefits, significant penalties in case of any form of surrender or fiscal disincentives, significant accrued benefits or final bonus, and the existence of significant in-the-money option and guarantees. P4 (50%) – includes half the Liquidity premium • All liabilities not falling under one of the five previous paragraphs shall be discounted with the risk-free interest rate term structure with a 50% illiquidity premium.
	Ref: TP.1.326	Assessing the liquidity premium on a contract basis is not representative for some insurance business (eg. discretionary benefits). The liquidity premium/ predictabilities of the liabilities should be assessed on an appropriate level of homogeneous groups of business where appropriate. The aggregation is proposed to be the level at which the undertaking performs the asset and liability management for the business.
	Mark-up	Suggested mark-up: "For insurance or reinsurance obligations which have discretionary benefits, the assessment of the percentage of the illiquidity premium is performed at a level of aggregation at which the liabilities and associated assets are managed."
	Ref: TP.1.330	**Extrapolation of the RFR** As short term mediations for QIS5 we propose: - Allow for country specific inflation where appropriate to adjust the UFR - Skip the requirement of a separate risk margin for non-hedgeable market risk, to keep consistency with the current suggested 4.2% level of the long-term rate (with a term premium set arbitrarily at 0). - Extrapolate the liquidity premium on the forward curve and not the spot curve (eg. extrapolating the spot liquidity premium to zero over 5 years implicitly assumes negative liquidity premia in forward space) Beyond QIS5, the long-term rates need further work and in particular the assumptions on the term premium and convexity adjustment. This should be done in combination with work on the grading towards this ultimate rate as those two elements cannot be seen in isolation. We recognise that given the timelines such work cannot be done before the QIS5 exercise. *Please refer to our separate memo on Base RFR / Extrapolation of LP*
	Mark-up	

Issue#	Reference	Description
H12	Ref: TP.2.19	**Diversification and risk mitigating effect of taxes in the risk margin** We welcome the definition of reference entity as set out in the QIS5 specifications, allowing for diversification between lines of business within one entity and between entities at group level. We consider that it is not an option to test diversification under QIS5 – we are pleased to see that Solvency II recognises diversification between risk categories and geographies. The risk mitigating effect of taxes should be reflected in the risk margin. The SCR reflects the risk mitigating effect of taxes. Since the risk margin is intended to be the present value of cost of capital on SCR, then it is inconsistent and unduly punitive to compute it based on something other than SCR (namely, SCR prior to reflecting risk mitigating effect of taxes). In addition, market consistent principles call for valuations at amounts for which liabilities could be transferred between knowledgeable and willing parties. Clearly, knowledgeable parties would reflect the risk mitigating effect of taxes on SCR.
	Mark-up	Delete in TP.2.19 'the loss absorbing capacity of deferred taxes is not allowed for'
H10	Ref: TP.2.67	**MVM on non-hedgeable financial risk** Based on current work of the CRO Forum workgroup on extrapolation, we suggest that the risk margin for non-hedgeable market risk and the extrapolation of the risk free curve should be considered simultaneously so as to avoid double-charging for the same risk. The risk margin takes into account capital required to offset the interest rate risk that cannot be hedged in the market. We believe that observed market data that is the starting point for extrapolation already prices in the risk that for longer tenors there is already a mismatch in supply and demand (forward curve is consistently downward sloping beyond 20yrs for all major currencies). Furthermore, the long-term rate assumes no term premium. A lower term premium results in lower extrapolated rates and therefore also less risk in the un-hedgeable part of the curve. We believe that the current extrapolation and risk margin are therefore not set consistently. We strongly recommend not having a separate risk margin for non-hedgeable financial risk given the current level/ design of the Ultimate Forward Rate (term premium has been arbitrarily set at zero). *Pease refer to our separate memo on Basic Risk Free Rate / Extrapolation of LP*
	Mark-up	Delete TP 2.67 or precise that for QIS5, the requirement of a separate risk margin for non-hedgeable market risk is removed, to keep consistency with the current suggested 4.2% level of the long-term rate (with a term premium set arbitrarily at 0).
	Ref: SCR.2.1	**Guaranteed benefits** The proposed definition of guaranteed benefits is asymmetric and only allows for the guaranteed benefits (i.e negative cash flows) while disregarding the positive cash flows associated with those guarantees.
		Drafting suggestion "This represents the value of future cash-flows, <u>both positive and negative,</u> which does not take into account any future declaration of future discretionary bonuses. ~~The cash-flows take into account~~ only those liabilities to policyholders or beneficiaries to which they are entitled at the valuation date <u>should be taken into account. Where guaranteed benefits are contingent on the payment of future premiums these should be taken into account in the cash-flow projection.</u>"
	Ref: SCR.2.23	**Single Equivalent scenario for the calculation of loss absorbency of TP and DT** We recognize that this method is theoretically sounder but it is more difficult to put in place, even for big companies. We cannot guarantee that this option will be widely tested in the course of QIS5 exercise.
	Mark-up	
H19	Ref: SCR.3.2 SCR.3.5	**Operational Risk Calibration** QIS 5 calibration for operational risk increases capital requirements to a level significantly in excess of regulatory expectation. We would welcome further clarity on the rationale for the recalibration. On geographical diversification, it is important to reiterate the need for geographical diversification, which becomes even more relevant in light of the recalibration exercise.

Issue#	Reference	Description
		Finally, the design of the operational risk module uses the Basic SCR (BSCR). This BSCR does not take account of the risk absorbing effect of future profit sharing and deferred tax. These risk absorbing effects are economically realistic and should be allowed for before calculating the operational risk.
	Mark-up	We therefore propose that the operational risk formula is amended, with BSCR replaced by (BSCR - Adj). Drafting suggestion: " BSCR replaced by (BSCR - Adj). Where Adj refers to risk absorbing effect of future profit sharing and deferred tax "
	Ref: SCR.4.2	**Intangible assets – clarification issue** We ask for clarification in the wording that intangibles from insurance contracts are not in scope of intangible assets - this is consistent with IAS38. (the definition needs to be clarified in the valuations section – see comment above) The valuation of intangible assets in V.1.5 is potentially different from the valuation of intangible assets for SCR purposes. SCR section on intangibles requires intangibles to be valued as per Article 75. However, there are additional requirements that must be met in the valuation section of the Spec otherwise the value of the intangible is set to zero. The intangible SCR stress should only apply when a non-zero value has been recognised to avoid double counting.
	Mark-up	The following should be clarified SCR.4.6 & SCR .4.7. "Fair value intangible assets **recognised on the balance sheet**"
	Ref: SCR.5.15	**Market risk correlations** We still have concerns with the correlations matrix as it's currently suggested, with high correlations for Property, FX. We refer here to the CRO Forum study in December 2009 on market risk correlations in the standard formula
	Mark-up	CRO Forum suggested correlations: Property/ Equity: [0.25; 0.5] with significant discrepancies across European countries vs 0.75 suggested in draft QIS5 TS Property/other asset classes: draft QIS5 TS systematically retained higher range from CRO Forum proposal FR/ other asset classes: draft QIS5 TS systematically retained higher range from CRO Forum proposal Our CRO Forum Proposal

To summarise, the CRO Forum suggested factors for the market correlation are:

CorrMkt	Interest Rate	Equity	Property	Spread	Currency	Concentration
Interest Rate	1					
Equity	CROF: 0.5 / 0 CP74: 0.5 / QIS4: (0; +/-0.25)	1				
Property	CROF: [0.25;0.5] CP74: 0.5 / QIS4: 0.5	CROF: [0.25;0.5] CP74: 0.75 / QIS4: 0.75	1			
Spread	CROF: 0.5 / 0 CP74: 0.5 / QIS4: 0.25	CROF: 0.75 CP74: 0.75 / QIS4: 0.25	CROF: [0.25;0.5] CP74: 0.75 / QIS4: 0.25	1		
Currency	CROF: 0.25 CP74: 0.5 / QIS4: 0.25	CROF: [0;0.25] CP74: 0.5 / QIS4: 0.25	CROF: [0;0.25] CP74: 0.5 / QIS4: 0.25	CROF: [0;0.25] CP74: 0.5 / QIS4: 0.25	1	
Concentration	CROF: 0 CP74: 0.75 / QIS4: 0	CROF: 0 CP74: 0.75 / QIS4: 0	CROF: 0 CP74: 0.75 / QIS4: 0	CROF: 0 CP74: 0.75 / QIS4: 0	CROF: 0 CP74: 0.5 / QIS4: 0	1

H11 — Ref: SCR.5.29

Consistency of Interest Rate shock with Extrapolation

As currently written, a stress of +25%/-30% for Interest Rate is maintained for maturities greater than 30 years. We recommend a reduction in the shock beyond 30 years:

- the calibration of the shock to the risk free interest rate term structure should be made compatible with the relative invariance of the ultimate long-term forward rate

- we note that the QIS5 assumption of a fixed charge beyond 30 years in fact results in an inconsistency with the MVM for non-hedgeable risk as well as this risk is double counted.

Although more work needs to be done in this area beyond QIS5, we advocate a preliminary reduction in the shock beyond 30 years for the purpose of QIS5, and we will offer CEIOPS a suggestion on what such a preliminary reduction could look like.

Need for clarification: it should be clarified that the "current interest rate curve" stressed is referring to basic risk free interest rate (i.e. discount rate without illiquidity premium – as defined in TP.1.341, pg 78) and not to the interest rate curve including liquidity premium, as .the illiquidity premium is already stressed as part of the spread risk sub-module.

Mark-up

Drafting suggestion:

"The altered term structures are derived by multiplying the current ~~interest~~ **basic risk free** rate curve by $(1+s^{up})$ and $(1+s^{down})$, where both the upward stress $s^{up}(t)$ and the downward stress $s^{down}(t)$ for individual maturities t are specified as follows:"

Ref: SCR.5.38

Financial mitigation/ dynamic hedging

The current wording on financial risk mitigation is inconsistent with article SCR12.24. Article 5.38 should be amended accordingly.

We welcome the current drafting of article SCR12.24, as it allows the recognition of dynamic hedging as an effective mitigation of risk, as long as it is well documented and automatic procedures are in place.

Pease refer to our separate memo on Financial mitigation with a simple formula to partially reflect dynamic hedging within the standard formula

Mark-up

" Undertakings should not allow for additional hedging instruments (for example, as part of a rolling hedging programme) beyond those in force at the balance sheet date within the standard formula SCR, unless the conditions under which the undertaking has the right to renew the hedge, are fully committed at the date of the solvency assessment and all costs for the renewal are taken into account in the SCR calculation. "

Our proposal to partially capture dynamic rebalancing in the standard model would be to allow for a rebalance after 50% of the shock.

- The idea behind this is that the full SCR equity shock is not happening overnight. So in reality any

Issue#	Reference	Description
		dynamic hedging program with an automated rebalancing (either daily rebalancing or based on market triggers), will have the ability to adjust after the initial shock in the market. • So, to conclude, when dynamic delta hedging is captured in an official hedge policy then the SCR can be calculated by applying 50% of the equity shock and multiplying the result by 2
	Ref: SCR.5.56	**Equity implied volatility shock** We note the new calibration of the equity volatility shock. Having worked further on longer tenor and related calibrations, we recommend a decline in the shock for tenor longer than 7Y. However, it's also necessary to highlight that the volatility shock is quite difficult to assess/ evaluate for "small companies" as it's based on EEV volatility sensitivities and the use of deterministic cash-flow is not possible. *Please refer to our separate memo on Volatility Risk*
	Mark-up	Applying a full term-structure might be complex for companies to apply in a standard model. Therefore, a suggestion could be to apply different shock buckets for tenors. A further potential simplification is that companies could still apply a single shock taking into account the profile and horizon of their equity linked options and guarantees... *Based on the above graph a simple manner in which to bucket could be to reflect:* 	Tenor	Equity volatility up stress (absolute amount)
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0-7yrs	10%
7-15yrs	5%
>15yrs	3%
Further simplification taking into account the profile of their equity linked options and guarantees *(eg. 20% of their options are 0-3yrs, 60% of their options are 0-7yrs and 30% 7-15yrs and 10% >15yrs)*	*Single equivalent shock would be equal:* *60%x10% + 30%x5% + 10%x3% = 8%*	
H16	Ref: SCR.5.94	**Treatment of Sovereign credit risk** We believe that it is not appropriate to apply these overly prudent market risk charges to holdings of all non-OECD sovereign debt (China, Singapore, HK, South Africa vs Malawi or Yemen). - We oppose the application of the excessive credit spread risk charges to non-OECD government debt on the following grounds: (i) there is no evidence that the credit risk on these governments is anywhere near as high as the spread charges shown in SCR.5.109, (ii) for insurance undertakings in many territories it is often part of the core business model to invest heavily in domestic government debt (due to the absence of other suitable investments). We recommend that home govies (ie. invested in the same countries where insurance contracts are underwritten) are not stressed for the fundamental reason that home govies are what local insurers have to invest in to back their liabilities. The stress is zero for OECD home govies and should also be zero for non-OECD home govies. *Pease refer to our separate memo on spread risk module.*
	Mark-up	Drafting suggestion: "No capital charge shall apply for the purposes of this sub-module to borrowings by or demonstrably guaranteed by: **a)** any national government (of any country including non-OECD countries), where that debt is being held by the undertaking to cover policyholder obligations denominated in the local currency of the relevant national government." **b)** national government of an OECD or EEA state, issued in the currency of the government, or issued by a multilateral development bank as listed in Annex VI, Part 1, Number 4 of the Capital Requirements Directive (2006/48/EC) or issued by an international organisation listed in Annex VI, Part 1, Number 5 of the Capital Requirements Directive (2006/48/EC).

Issue#	Reference	Description
H14	Ref: SCR.5.109 SCR.5.119 SCR.5.125	**Spread Risk Calibration** The calibration of the credit spread risk module (bonds, non-OECD sovereign, structured products, credit derivatives, covered bonds) has increased considerably compared with QIS4. The level of credit shocks proposed for corporate debt and structured credit (also considering the additional qualitative requirements) will potentially causing severe dislocation in the capital markets across the EU. *Pease refer to our separate memo on spread risk module which details our counter-proposal of calibration for each rating & type of assets. This paper reiterates our Market Risk calibration study published last March.*
	Mark-up	**Calculation of Spread risk charge** As currently drafted the calculation applies the maximum of the widening/narrowing at the wrong point. The maximum point should be applied to the next effect of assets falling (less changes in liabilities) at the overall level to capture appropriate asset mixes. We therefore suggest a mark up solution of moving the max from 5.108 into 5.107. The capital charge for spread would be: Max{ [mktsp(bonds) + mktsp(struct) + mktsp(cd) + mktsp(re) - deltailliquid liabs]up; [mktsp(bonds) + mktsp(struct) + mktsp(cd) + mktsp(re) - deltailliquid liabs]down)}. **Bonds:** Table: Corporate Bond Credit Spread – draft QIS5 specifications vs. CRO Forum Proposal (called option2 in our previous submission published in March 2010) *(table below)* **Structured products** The CRO Forum proposes that the stress tests based on the rating of the structured products are re-calibrated to be equivalent to the corporate bond stress tests multiplied by a scaling factor of 1 for investment grades (ie. applying directly the corporate bond stress) and a scaling factor of 1.5 for other ratings (ie. applying 1.5 x corporate bond stress for BB and ratings below). Table: Structured Products Credit Spread – corresponding scaling factor of max observed default rates of CDOs with the corporate bond stresses proposed by CEIOPS in the final advice *(table below)* **Credit derivatives** In the CEIOPS final advice, CDS (not qualifying as hedges) subject to 600% spread widening or 75% spread narrowing. We strongly disagree with this arbitrary approach. In the calibration, CEIOPS focused on the CDS sold by institutions that defaulted during the crisis which created inconsistency with the calibration and the treatment of bonds. The issue of the default of the counterparties in CDS transaction

Spread UP

	AAA	AA	A	BBB	BB	B	Unrated
Draft QIS5 TS	100 b.p.	150 b.p.	260 b.p.	450 b.p	840 b.p	1620 b.p	500 b.p
CRO Forum Proposal – option 2	(120 b.p.) (*)	140 b.p.	190 b.p.	300 b.p	875 b.p	1205 b.p.	300 b.p.

the corporate bond stresses proposed by CEIOPS in the final advice

Term	AAA	AA	A	BBB	BB	B	CCC
1	-	0.1	0.6	0.6	1.6	2.8	-
2	0.3	0.1	0.4	0.7	1.5	1.9	0.3
3	0.4	0.2	0.4	0.7	1.3	1.6	0.4
4	0.3	0.2	0.4	0.7	1.2	1.5	0.3
5	0.3	0.2	0.3	0.6	1.1	1.3	0.3
6	0.3	0.2	0.3	0.6	1.0	1.2	0.3
7	0.2	0.2	0.3	0.6	0.9	1.2	0.2
8	0.3	0.2	0.3	0.6	0.9	1.3	0.3
9	0.2	0.2	0.3	0.5	1.0	1.3	0.2
10	0.2	0.2	0.3	0.5	1.1	1.3	0.2

Issue#	Reference	Description
		is more relevant in the calibration of the counterparty sub-module. Credit Default Swaps should be treated in the same way as corporate bonds (i.e. based on the rating of the underlying name). For the calibration of CDS in the spread module, CEIOPS should use the same data used in the calibration of bonds in the final advice (ie. CDS data and not real bonds index). **Covered Bonds** For covered bonds (eg. German Pfandbriefe, Spanish Cedulas), we propose far lower shock both under the spread risk and concentration risk sub-modules. These bonds should have a specific treatment that appropriately reflects their risks. As an example, German Pfandbriefe could benefit from a AAA shock set at 1%, and not 8% as currently written.
H15	Ref: SCR.5.115	**Spread Risk Design** We welcome the introduction of the illiquidity premium stress in the spread risk module. However, careful consideration will need to be given to the application of the liquidity premium to the liabilities (eg. allocation to the "predictability buckets") in order to ensure appropriate results under the spread risk module. The current drafting of this module leaves room for ambiguity; we therefore request clarification on the way the 'liability adjustment' should be applied in the formula (SCR.5.115.) and we suggest a formula. *Pease refer to our separate memo on spread risk which details our interpretation of this liability adjustment and how the formula should be detailed.*
	Mark-up	CRO Forum Liability adjustment = Market Value (Liabilities) * duration of the liabilities * Predictability Ratio * (equivalent shock for the Iboxx portfolio) * 50% (ie, shock to apply on implied Liquidity Premium)
	Ref: SCR 5.102 & 5.104 SCR.5.122	**Structured products - practical issue** For structured products, QIS 5 asks us to look through to the rating of the underlying collateral; in our experience, such collateral usually is not rated. We therefore suggest removing that paragraph. SCR.5.122 requires a 100% capital charge for structured credit products where the originator fails to hold 5% net retention. This paragraph ignores that for structured products issued up until 1 Jan 2011 the 5% retention requirement shall only apply from 31 Dec 2014, not present day, as per CEIOPS final advice (CP63 – para 3.60) and draft implementation measures (IM18). The transitional arrangement proposed in CEIOPS final advice and draft IMS is consistent with the transitionals allowed under CRD. *Pease refer to our separate memo on spread risk module which details our counter-proposal of calibration for structured products. This paper reiterates our Market Risk calibration study published last March.*
	Mark-up	Delete SCR 5.102 & 5.104 on the underlying collateral In SCR.5.122, the requirement to test the 5% retention should be tested as a sensitivity to the base case rather than tested as part of the base case. Drafting suggestion: SCR.5.122. " As a sensitivity test to the base case where if the originator of a structure credit product does not comply with the 5% net retention rate foreseen in the CRD (2006/48/EC), the capital charge for the product should be 100%, regardless of the seniority of the position.
	Ref: SCR.5.139	**Sovereign concentration risk** Similarly to our comment on SCR.5.94, this article also implies that holdings of government debt in non-OECD governments would not be exempt from the concentration risk SCR module, and thus would be subject to the concentration charges. We therefore recommend not applying any concentration risk on home-governments (ie. invested in the same countries where insurance contracts are underwritten), in particular for non-OECD home-governments.
	Mark-up	Drafting suggestion: "Government bonds are exempted from the application of this sub-module. The exemption concerns

Issue#	Reference	Description
		borrowings by or demonstrably guaranteed by:
		a) <u>any national government (of any country including non-OECD countries), where that debt is being held by the undertaking to cover policyholder obligations denominated in the local currency of the relevant national government."</u> b) national government of an OECD or EEA state, issued in the currency of the government, or issued by a multilateral development bank as listed in Annex VI, Part 1, Number 4 of the Capital Requirements Directive (2006/48/EC) or issued by an international organisation listed in Annex VI, Part 1, Number 5 of the Capital Requirements Directive (2006/48/EC).
H18	Ref: SCR.7.37	**Life risk calibration** We have concerns pertaining to the design of the Longevity risk sub-module (not risk sensitive as it is independent of the age of the insured or the duration of the contract), the calibration of the Life risk Mass lapse stress that has not been supported by evidence, non-recognition of natural hedges, non recognition of geographical diversification. Longevity risk charge which is independent of the age of the insured or the duration of the contract is not sufficiently risk sensitive. We would like to refer to Unespa/Towers Perrin study that outlines the shortcomings of the CEIOPS calibration, in particular, basing their calibrations over a 15 year horizon as opposed to a 12 month horizon described in the Directive for the calculation of the SCR. In addition, we support the proposal set forth by the Danish study for calibrating the longevity risk which is in line with the one year VaR(99.5%). A one-off shock in the range 10% - 15 % is appropriate for calculating the capital charge for longevity risk.
	Mark-up	"Longevity shock = a (permanent) ~~25%~~ **13%** decrease in mortality rates for each age"
H18	Ref: SCR.7.63	**Mass lapse risk** – charges are too high, especially considering the fact that mass lapses in response market risk stresses are already included in that module. Non-Retail business is not defined in either the level 1 directive or the QIS 5 draft specifications. We suggest changing "non-retail business" to "the insurance policies falling within Article 2(3)(b)(iii) and (iv) of Directive 2009/138/EC" (consistent with the commissions draft proposal on the implementing measures. 70% for this business is very onerous and not justified,. 30% for the remaining contracts would be more appropriately set to 15-20%, in line with CEA study: *Please refer to the CEA paper:* *http://www.cea.eu/uploads/DocumentsLibrary/documents/1255534197_cea-additional-contribution-on-cp49-mass-lapse-risk.pdf*
	Ref: SCR.8	**Health Risk** Note that comments below are only preliminary comments as we are currently waiting for the conclusions from the CEIOPS taskforce on Health - We support CEA paper on Health, and the Industry is actively involved in the EC health taskforce. The segmentation of the Health Non-SLT module and its calibration should be reviewed in line with the industry proposal. - CRO Forum survey confirms that draft QIS5 calibrations are far too high and based on a non-representative number of Member States. - We do however recognise that various social security systems in Europe lead to very different risk profiles. So undertaking specific parameters should be widely used by undertakings (ie. same flexibility as in QIS4);
	Mark-up	
	Ref: SCR.8.66	We seek confirmation that different products can be included in a single LoB in non-SLT provided they are sufficiently homogeneous.
	Mark-up	
	Ref: SCR.8.119	Under Concentration risk we are asked to calculate a capital charge which involves making an assumption for Medical Expenses business of the 'average claim paid...in respect of hospital treatments for accidental causes'. Further guidance is requested on how this should be calculated were the risk is restricted to the cost of follow up treatment.

Issue#	Reference	Description
	Mark-up	
	Ref: SCR.8.122	Under Concentration risk we are asked to base exposure on the scheme with the 'largest known concentration of lives'. It is not clear whether this is intended to capture the largest concentration within scheme or in a single location.
	Mark-up	
	Ref: SCR.8.128	Under Pandemic risk the capital charge formula appears incomplete and should include terms relating to market penetration and market share, or alternatively the Ep term should be redefined to be the total rather than average exposure
	Mark-up	
H17	Ref: SCR.9.30 SCR.9.38 SCR.9.42 Annex K	**Non-life Calibration** We recommend further consideration of insurers' internal models experience in the calibration of underwriting risk in the standard formula, which reflects empirical evidence, therefore, adopting lower calibration factors. Despite improvements, recent recalibrations of insurance risk parameters are still overly conservative (~+20% on average for non-life compared to QIS4 and up to +50% for some lines of business). The industry does not find evidence that such increases compared to QIS4 can be justified. The recent financial crisis should not be justification for the massive increase in the shocks inconsistent with historical evidence. The increase is even more exaggerated when considering the calibrations included in the internal models of major European insurers as evidenced in the CRO Forum's non-life calibration benchmark survey (accounting for 26% of Europe's Gross Earned Premiums). Under such prudent calibrations, allowance of the use of Undertaking Specific Parameters becomes crucial; and should be widely allowed and facilitated by regulators. Fully recognizing risk mitigation and diversification is a crucial element to promote best risk management practices. We welcome the improvements to capture the effects of risk transfer through non-proportional reinsurance as well as the partial recognition of geographical diversification. However, we have issues with the granularity of the geographical segmentation (based on U.N geo schemes and not on a country granularity) and the level of the cap built into the Herfindahl index (that should not become a benchmark applied to Internal Model) that leads in practice to drastically reduce the intended level of diversification benefit. We recommend to use a geographical segmentation closer to QIS4 (refer to Annex K) and to test both a 25% cap and 50% cap in QIS5. Even though the Catastrophe risk module is very likely to result in more sensible risk assessment, we expect further discussions and clarifications from the CAT taskforce, as this module currently appears capital intensive compared to QIS4. *Please refer to our separate memo on non-life risk that reiterates our concerns over the treatment of the non-life underwriting risk module and present publicly the results from the CRO Forum benchmarking study on calibrations within Internal model.*
	Mark-up	
	Ref: SCR 9.20 & SCR.9.32	**Non Life Premium written – need for clarification** The current formula for volume is unclear; there is a risk of double-counting on Premium written and C(Lob, PP). In particular the wording: "changes in provisions on claims after the year as a result of new information" may lead to a double counting on Non-earned Premium. This is not clear why the CPP term is to be included into the volume measure. Indeed the risk on URR at the end of the current year due to events or additional information arising this year, has a completely different nature from the risk on current underwriting itself. Thus should the risk be included, this could not be as simple as an additional item in volume measure
	Mark-up	Delete this CPP term
	Ref: SCR.9.46	**Clarification on the scope of the lapse risk module** Clarification is needed on the scope of the lapse risk module. The Non-Life lapse risk should be

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		included, only, where the value of corresponding premiums is recognized in Own Funds. *Please refer to our separate memo on Non-life risk*
	Mark-up	
	Ref: SCR.9.4	**Please refer to our separate contribution to the CEIOPS CAT taskforce**
	Mark-up	
	Ref: SCR.10	**USP** Under such prudent calibrations, allowance of the use of USPs becomes crucial. We argue that the use of USPs should be supervised in the most flexible way: • The use of undertaking specific parameters should not be restricted in terms of the scope of risks which are covered and the methods which can be used. The restriction of methods to the "standard methods" proposed in CP 75 will, in most cases, make it impossible to obtain valid results. At least we expect CEIOPS to be flexible in the use of frequency / severity approach proposed for Premium risk (e.g. in calibration methods, and reinsurance per risk treaties modelling). • A time frame should be settled for approval process; especially USP should be allowed from the early implementation of Solvency II in 2012. • We agree on the "completeness, accuracy, and appropriateness of data" criteria. We would, however like to ensure that these criteria will not be reviewed by local regulators in too restrictive manner, possibly inconsistent with CEIOPS data, as well as "robust and reliable estimation" criteria. • We strongly expect that USP will be allowed through a much flexible and simplified validation process of the regulator in comparison to the full internal model. *Please refer to our separate memo on Non-life risk*
	Mark-up	
H7	Ref: SCR.11.2	**Ring-fenced funds** The definition of ring-fenced funds causes a significant amount of uncertainty. It is not at all clear what the definition under SCR 11.2 (a) refers to and it appears to add funds on top of those referred to under Level 1 (Level 1 refers to restricted Own Funds only). • The effect of barriers to the sharing of "profits and losses" should already be captured under the net asset valuation approach and the recalculation of Technical Provisions allowing for discretionary benefits. • Furthermore, the definition of ring-fenced funds should refer to those funds that are restricted on a going-concern basis only (in line with the definition of the SCR and the technical provisions). Own funds that are restricted on a winding-up basis would be set as Tier 2 rather than being excluded, under the tiering characteristics of Level 1. *Please refer to CEA paper on ring-fenced funds:* *http://www.cea.eu/uploads/DocumentsLibrary/documents/1271423792_cea-position-on-ring-fenced-funds.pdf*
	Mark-up	
	Ref: SCR.12.24	**Way to capture dynamic hedging in the standard formula** We welcome the current drafting of article SCR12.24, as it allows the recognition of dynamic hedging as an effective risk mitigation tool, as long as it is well documented and automatic procedures are in place. *Please refer to our separate memo on Financial Mitigation with a simple formula to partially reflect dynamic hedging within the standard formula*
	Mark-up	Please refer to our comment on SCR.5.38
H13	Ref: SCR.12.29	**Hedging instruments in all risk modules** Hedging instruments in all risks modules are only allowed with the average protection level over the next year. We strongly disagree with this treatment as it contradicts the main aim of Solvency II, namely

Issue#	Reference	Description
		having an economic framework. We understand that the idea is to prevent firms from window dressing, i.e. to avoid that derivatives are only installed shortly before the reference date and only for a very short time. As a compromise we suggest that hedging instruments with an average protection level of less than one year shall be fully allowed, under the condition that the firm has a well documented hedge policy in place and that the hedges are part of this hedge policy. *Please refer to our separate memo on Financial Mitigation*
	Mark-up	Delete SCR.12.29
H20	Ref: SCR.13.7. & SCR.13.8.	**Reinsurance risk mitigation** QIS5 includes the requirements that (1) a reinsurance mitigation technique should not include a material basis risk (SCR.13.7) and (2) that no allowance shall be made for finite reinsurance or comparable SPV constructions in calculating the SCR of the non-life premium and reserve risk-module (SCR.13.8 2nd bullet point). We recommend the recognition of the existence of a capital reduction for all reinsurance risk mitigation techniques in calculating the SCR standard formula, as long as a genuine transfer of risk takes place. Furthermore, we suggest not using clauses such as the ratio of transferred premium to gross premium (as is the case in SCR.13.8 1st bullet point) for the recognition of recoverables or premiums for reinsurance risk mitigation technique. If for instance a significant and fairly stable "bulk business" is not reinsured, the ratio of net to gross risk of the overall portfolio may then be smaller than the ratio of net to gross premium.
	Mark-up	Delete SCR.13.8 1st bullet point
	Ref: SCR.13	**Counterparty for internal reinsurance** Counterparty exposures to internal reinsurance (clarifying that group rating would be used to assess counterparty exposures for internal reinsurance)
	Mark-up	
H1	Ref: OF 7,8 & 9	**Treatment of excess of assets over liabilities** In defining eligible own funds, a departure from the economic total balance sheet approach could have an impact in excess of €100bn for the European Industry. In this respect, we welcome the classification of the excess of assets over liabilities as Tier 1. We understand, however, that the recognition of 'expected future profits' as high quality Tier 1 own funds is still being challenged. We believe this is at least in part due to a misunderstanding on the nature of these own funds under an economic balance sheet. We note that the term of 'expected future profits' may be misleading and we prefer to refer to them as 'in-force cash flows'. The inclusion of in-force cash flows in the definition of own funds is consistent with the economic basis of Solvency II, and not including them as tier 1 capital would introduce an inconsistent treatment between assets and liabilities resulting in an unduly conservative approach to the solvency assessment (own funds vs. capital requirements) arising from double counting of the associated risk. Possible variation of in-force cash flows is allowed for explicitly in setting required capital. Not including them in tier 1 capital would lead to double counting of risk. The potential quantitative impact of an inappropriate treatment of in-force cash flows would be of the order of €100bn for the industry, based on the current proposals for tiering limits that are far more conservative than what has been voted for in the Directive (min 50% of Tier1 and max 15% Tier3 to back the SCR). *Please refer to the joint Industry paper: 'Why expected future profit must be treated as Tier1 capital' published on April, 19th 2010* *http://www.croforum.org/publication/why_expected_future_profits__must_be_treated_as_tier_1_capital/*

Issue#	Reference	Description
		Similarly, there should not be a re-examination of the following items under the tiering restrictions,. These should be classed in full as Tier 1 capital: • Any differences between Solvency I balance sheets and Solvency II (e.g. Equalisation provisions) • Deferred tax assets: - We deem it inappropriate to only consider DTA without consideration of DTL. DTA has a clear economic value and a loss absorbing capacity when it is available - at least equal in amount of DTL. Only the excess of DTA over DTL could have a reduced loss absorbing capacity, unless there is convincing evidence that sufficient taxable profit will be available in the future against which the deductible temporary differences, the unused tax losses and unused tax credit can be utilised - We strongly believe that the application of the tiering concept in order to mitigate the risk of limited loss-absorbing capacity will lead to double counting of capital requirements. As a matter of fact, the tiering approach is appropriately applied to sources of capital which are exposed to risks that are not reflected in the calculation of Solvency Capital Requirement ("SCR"). Since the risk of limited loss-absorbing capacity of DTA is already reflected in the calculation of SCR, it would be inappropriate to reduce available capital by classifying a great part of DTA in Tier 3, rather than in Tier 1, and to put the insurer in the position to raise capital twice to cover the same risk
	Mark-up	OF5 - "The following basic own-funds items shall be classified as Tier 1**. In the case of items listed in 1(a), 1(b), 1(c), 1(g) they shall be Tier 1** provided that they meet the criteria set out in paragraph OF.7 and where applicable paragraphs OF.8 and OF.9:"
	Ref: OF.6	**Adjustment on Tier1 items** This para suggests that the own funds that qualify as Tier 1 would be further reduced by items such as restricted reserves, ring fenced funds etc. Moreover, the para also suggests that all of the ring fenced fund will be taken out of the Tier 1 own fund. This is inconsistent with the RFF section (SCR.11.26); which allows for the recognition of future transfers attributable to shareholders in respect of profit sharing arrangements. Therefore, only surplus policyholder's share of RFF should be excluded from own funds.
	Mark-up	"The total ~~of the above amounts~~ **own funds** will be reduced by adjustments in respect of the following items: …. c) **Own funds arising from the policyholder's share of** ring fenced funds"
H5	Ref: OF.2.4	**Treatment of Participations at Solo Level** Treatment of all strategic participations should be consistent. The value of all non-insurance financial sector participations being excluded from the own funds of the solo entity could lead to regulatory arbitrage and an understatement of the risk in respect of solo entities that have participations in other financial sector entities. Instead we recommend that they should be treated either as any other (strategic) equity investments subject to an equity shock in SCR of 22% provided that the double gearing is eliminated at group level or with a "look-through" approach (ie. consistent with the treatment of participations for groups as outlined in section G.2.2), when relevant information is available and in the context of the application of an Internal Model. Moreover we disagree with the full deduction from own funds of intermediate holding companies. Such treatment does not have any economic background and is more penalising than proposals under the CEIOPS Final Advice (former CP67). The QIS 5 draft specification requires the deduction of own funds for all holding companies, insurance and financial, while the CEIOPS proposal only required the deduction for non insurance holding entities. We are not convinced that it is correct to apply implied volatility shocks to participations, considering that there is often no market implied volatility for a participation (because the participation itself is not traded).

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	Mark-up	We consider that the existing proposal for the treatment of participations at solo level is proposed in an interest of a simplistic approach for the standard formula. Where internal models are used the undertakings should be allowed to use the same approach for participations as for outlined for groups in section G.2.2 Drafting suggestion: OF2.4 – Pg 374 "For the purposes of QIS 5, the table below sets out the approach to be followed in relation to the different types of participations and subsidiaries **for the standard formula**." OF14a [**new**] – Pg 375 "**As an option – where undertakings are using an internal model and have the capability and the capacity to do more sophisticated calculation they should follow the participation treatment as outlines in G2.2 for groups**."
	Ref: OF.5., and OF.6.	**Deferred Tax Assets** The proposed 12 months cut off is arbitrary and does not reflect the underlying economics. Recognition of deferred tax assets in the balance sheet should be consistent with IAS 12 and fully allowed in tier one own funds. *Please refer also to our H1 high level issues*
	Mark-up	Presumably OF.5 (f) should be drafted to say "*Amounts representing deferred tax assets that the undertaking **shall use** within the following 12 months **or** which **can be** legally transferred to another entity*" (Otherwise this paragraph will be in contradiction to OF.17.)
	Ref: OF.13	**Restricted reserves** The nature of Restricted reserves is very unclear. These reserves should not include ring fenced funds as indicated in the footnote to para 3.95 in CEIOPS final advice on own funds (CP46). In addition, ring fenced funds are covered separate from restricted reserves in OF.6(c) and SCR.11. We therefore recommend removing this notion of 'restricted reserves'.
	Mark-up	OF.2.3 - "Reserves **(other than Ring fenced funds)** the use of which is restricted."
H2	Ref: OF.36	**Grandfathering Hybrid Debt Arrangements** We welcome the introduction of grandfathering for hybrid debt in QIS5, and more generally under Solvency II to avoid any market obscurities. In order to make sure that there will be an EU-wide level playing field grandfathering rules should be based on currently existing EU-wide Solvency I rules, where available. If none available, then we suggest the following rules to be tested under QIS5: • Tier 1: perpetual Solvency I compliant instruments; and • Tier 2: dated Solvency I compliant instruments.
	Mark-up	Replace OF.36 with: "grandfathering rules should be based on currently existing EU-wide Solvency I rules, where available. If none available, then we suggest the following rules to be tested under QIS5: •Tier 1: perpetual Solvency I compliant instruments; and •Tier 2: dated Solvency I compliant instruments."
	Ref: OF.36	Contrary to the grandfathering rules for existing hybrid capital instruments, the criteria for Solvency 2 compliant hybrids are not immediately relevant for QIS 5 calculations, since such Solvency 2 compliant hybrids do not yet exist. However, we note that more work needs to be done by all involved parties on this issue in order to draft criteria that (i) provide sufficient loss absorbency to protect the interest of policyholders, (ii) but also allow for the cost efficient issuance of instruments without undue structural complexity.
H8	Ref: G.1.5 Ref: G.68-	**Fungibility/Transferability of Own Funds at Group level** The Industry welcomes the fact that fungibility and transferability of own funds should not be proved within a night but within a 9 months (6+3 months) period of time, which is consistent with what has been

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	69	voted for in the Directive (article 138 'non-compliance with the SCR'). We request clarification, however, on what we should disclose to our regulators for the QIS5 exercise in evidence of this item. We reiterate our position that ultimately almost all items could be made transferable because one could always sell these items/ entities at their NAV (less a cost to sell). In addition, own funds can be made fungible through active capital management such as restructuring or internal reinsurance. The consideration of fungibility must be separate from consideration of the Group SCR and diversification. The issue of fungibility should apply to the extent that any restriction (eg. caused by a ring fenced fund) is not reflected in the calculation of the Group SCR. We advocate for an unrestrained calculation of the SCR and Own Funds at Group level. This should be followed by an assessment of the impacts of fungibility constraints on the own funds by identifying the fungible and non-fungible shares of the excess capital at group level, by supervisors.
	Mark-up	G.18. "This assessment needs, in particular, **to** consider the availability of the own funds of each entity within the scope of group solvency. This means that own funds that can not be made both fungible (i.e. absence of dedication to a certain purpose) and transferable (i.e. absence of significant obstacles to moving assets **representing those own funds** from one entity to another of the group **or that limit the ability to make the value (by reference to Directive 2009/138/EC) of those own funds available**) for the group within a maximum of 6 to 9 months (Article 138.3) can not be considered effectively available at group level."
	Ref: G.7	**Group capital requirements and own funds** We question why both the Consolidation method and the Deduction and Aggregation (D&A) method should be performed for the calculation of group own funds in all scenarios? Assuming no equivalence and thus the application of Solvency II rules to all entities, both the Consolidation and D&A methods should come up with the same result except for the following difference: • The risk margin calculated using the consolidation method will incorporate diversification effects. • The risk margin calculated using the D&A method will be a simple sum of solo risk margins. All other balance sheet items should be the same under both the D&A and Consolidation methods. Since the D&A method will require a great deal of time and effort, we strongly recommend that the requirement to calculate own funds using the D&A method should be eliminated. We agree, however, that the D&A and consolidation methods will lead to different results when calculating the group SCR. We therefore have no objection to calculating both methods for the SCR.
	Mark-up	
	Ref: G.58.-59.	**SCR Floor** QIS5 proposes that the minimum contribution to the group SCR should be the local capital requirement corresponding to the final intervention point of the local supervisor for non-EEA entities and other financial sector entities. For non-EEA entities local statutory requirements should not be used inappropriately, in particular in the group SCR floor under the default group aggregation method that leads to an incoherent mixture of capital requirements on different bases (Solvency II and local statutory requirements). Moreover: • This is inconsistent with the directive (Art 203(2)) • The SCR floor is only applicable to Method 1 to ensure that the diversified SCR does not fall below the sum of (undiversified) MCR. • Basing an SCR floor on MCR equivalent for local/sectoral is nonsensical, since it does not contribute to the diversification (something the SCR Floor aims to capture), and such a treatment will distort the results of QIS5.
	Mark-up	Delete G.58 & G.59
	Ref: G.69.	**Consolidation method: aggregated own funds** The example on page 404 in sub-section G 69 is not easy to follow or understand. We are not sure what it is aiming to explain. In particular it is unclear why the diversification penalty applied to the own funds of entity C is equal to the total diversification benefit of the whole group when part of this diversification

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		benefit will have arisen from combining entities A and B.
	Mark-up	
	Annex K	**Geographical segmentation in Health/ Non Life** The geographical segmentation (based on U.N. geo-scheme) has been drastically amended and in practice does not recognise any diversification within some EEA countries (eg. for Western Europe: France, vs Germany, vs Switzerland). We propose returning to a more granular segmentation for the EEA and the rest of Europe derived from QIS4 (i.e. each country of the EEA, Switzerland, the rest of Europe). For the rest of the world, we would support testing the proposed split during QIS5.
	Mark-up	Return to a more granular segmentation for the EEA and the rest of Europe derived from QIS4