The European Insurance CFO Forum
Solvency II Working Group
C/O Amélie Breitburd
AXA
23 Avenue Matignon
75008 Paris
FRANCE

CEIOPS-Secretariat
Committee of European Insurance and Occupational Pensions Supervisors
Westhafenplatz 1
60327 Frankfurt am Main
Germany

22 May 2009

Dear Sir / Madam

CFO Forum response to CEIOPS Consultation Paper 27: Technical Provisions – Lines of business on the basis of which (re)insurance obligations are to be segmented

Please find attached the CFO Forum's response. We regret that we were unable to formulate our response by 3 May 2009 deadline and we respectfully request that our observations be taken into consideration.

The CFO Forum has now mobilised a Solvency II Working Group, which will be responsible for developing responses to consultation papers on a timely basis going forward. This working group will be particularly focusing on issues relating to the Solvency II balance sheet, governance processes and public disclosures. We look forward to communicating regularly with CEIOPS and supporting the development of Solvency II.

Yours sincerely

Amélie Breitburd
Chair
CFO Forum, Solvency II Working Group

Comments on Consultation 27-09 Draft L2 Advice on Technical Provisions – Lines of business on the basis of which (re)insurance obligations are to be segmented	
CFO Forum	
Please insert your comments in the table below, and send it to secretariat@ceiops.eu in word format. In order to facilitate processing of your comments, we would appreciate if you could refer to the relevant section and/or paragraph in the Consultation Paper 27-09.	
Reference	**Comment**
General comment	**Segmentation should not conflict with the way business is managed** – For measurement purposes, the segments chosen should not conflict with the way insurers manage their business. It is also noted that the current proposals potentially have some conflicts with IFRS classifications, as well as other requirements. In particular, IFRS 8: Operating Segments requires financial reporting disclosures to be "through the eyes of management". It is therefore likely that only a few high-level segments are appropriate. In particular we would not support any segmentation requirements that split up an insurer's lines of business, rather insurers should be able to map the lines of business they work with into the segments chosen by CEIOPS. Segmentation requirements that are inconsistent with the way insurers manage their business and collate data will also have significant practical implications for data management systems. The CFO Forum appreciates that data needs to be collected in consistent regulated lines of business for the purpose of harmonisation and authorisation. For the sake of harmonisation, local regulators should not introduce additional requirements regarding segmentation. The presentation of information should not pre-define the segments used to estimate technical provisions, in particular **the level at which diversification benefits shall be computed**. The relevant granularity at which risk margins should be assessed could be much wider than the granularity of disclosure requirements. In some instance an aggregated measurement basis followed by an allocation approach may achieve more accurate and reliable estimates than a more granular measurement approach. **There should not be a minimum requirement to unbundle components of insurance contracts** – The CFO Forum does not support the unbundling of components of insurance contracts for measurement of insurance liabilities. Insurance contracts are often composed of a bundle of risks and services. The valuation of those risks and services are often

CFO Forum	
	interdependent and the value of the risks and services for the entire insurance contract is not equal to the sum of the values of the separate risks and services. Unbundling such interdependent elements of insurance contracts requires additional judgement and results in a spurious degree of accuracy in the final measurement approach. Insurers should not be required to unbundle insurance contracts unless the components are clearly separable and independent and can be measured reliably. Contracts should be allocated to segments based on the main risk characteristics of the contracts. **<u>Segmentation requires flexibility and pragmatism</u>** – We would like to emphasise the need for flexibility and pragmatism in the application of the proposed segmentation. In some cases, the choice of one segment compared to another might be difficult (for example: "Worker's Compensation" vs. "Accident", "Sickness" or "Health"). The choice made by the company will often rely on expert judgement and as the company is in the best position to know the business it is writing, the company's choice should be presumed appropriate. The volume of statistically reliable data is a driver of the level of segmentation of insurance contracts for measurement purposes. Where large volumes of statistically credible data exist, this will support more detailed analysis of component risks. Segmentation should not require companies to conduct assessments on low volumes of volatile data where an aggregated approach would provide a more credible subset of data on which to conduct estimates. In this context we highlight that most analysis is conducted on data with some degree of heterogeneity of risks. A balance needs to be achieved between having a sufficient volume of data given the underlying volatility of that data compared and seeking to identify the sources of that volatility and attributing it to different categories of risk. Whilst it is noted that it may be appropriate to use different segmentations for measurement of best estimates, risk margin, MCR and SCR, we consider that the principles for segmentation should not preclude insurers from using the same level of segmentation for all measurements. In this regard the segmentation applying to best estimates and risk margins for the purpose of technical provisions should be able to be consistent with internal models used by companies which may model some risks at a higher level of aggregation then allocate values to a more granular level.

Comments on Consultation 27-09 Draft L2 Advice on Technical Provisions – Lines of business on the basis of which (re)insurance obligations are to be segmented	
CFO Forum	
Section 1	**<u>Undertakings should define the level of granularity appropriate</u>** - The CFO Forum agrees that it will be appropriate for each undertaking to define the homogenous risk groups and the level of granularity most applicable to their business. **<u>CEIOPS advice relates only to minimum segmentation</u>** – The CFO Forum agrees that this is appropriate. Further CEIOPS advice should not require undertakings to subdivide risks between segments for measurement purposes when: • The level of segregation is disproportionate to the risks being measured. • The level of segregation would require the separation of risks where interdependency is established within contract structures. • The resulting volume of data for each segment is not statistically credible given the inherent volatility of the risks being measured. **<u>Consideration should be given to health products that combine life and non-life parts</u>** – In Health insurance there are products which have life and non-life characteristics/parts. We hope that the missing suggestion for health segmentation, as mentioned in this paragraph, will allow for this circumstance.
Section 3.1.1 Para 3.9	**<u>Substance over form</u>** - the principle of substance over form as set out in this paragraph should be included in the level 2 implementing measures.

Comments on Consultation 27-09 Draft L2 Advice on Technical Provisions – Lines of business on the basis of which (re)insurance obligations are to be segmented	
CFO Forum	
Section 3.1.2	**Non-life contracts allocated to segment by main risk drivers** - The CFO Forum considers that contracts should be allocated to segments based on the main risk drivers under the contract. There should be no requirement for incidental risks to be allocated to separate segments. Undertakings should decide whether further segmentation to risk for estimation purposes will result in a more reliable estimate. It is not necessarily appropriate to bundle all liability claims together. Where incident liability risks are associated with property contracts for example motor, household, commercial packages, marine, aviation, undertakings should decide whether the liability element is sufficiently material and can be estimated reliably as a separate component of the valuations. It may frequently be concluded that a more reliable estimate of incidental liability claims is based on analysis of the combined property and casualty risks for these classes. **Annex 1 of the Level 1 text refers to separate "Accident" and "Sickness" classes** – We would request that this was clarified within the paper, as the proposal of CEIOPS is not in line with Level 1 text. The classification requirements should be materiality based and granular classification requirements should not apply for non-material businesses.
Section 3.1.3	**One segment for inwards reinsurance** - The CFO Forum does not support a separate treatment of proportional and non-proportional reinsurance, as a minimum segmentation requirement. It is in favour of a single business line including both proportional and non-proportional reinsurance (to be called for example "Accepted Reinsurance"). Further, when inwards reinsurance business has similar characteristics to direct business and is managed as part of a combined direct and inwards reinsurance portfolio, it is not appropriate for the entity to separate the insurance and reinsurance contracts for measurement purposes. There should be no minimum requirement to separate direct and inwards reinsurance business.

Comments on Consultation 27-09 Draft L2 Advice on Technical Provisions – Lines of business on the basis of which (re)insurance obligations are to be segmented	
CFO Forum	
Section 3.1.4	**<u>Long term health insurance has not been considered</u>** - The CFO Forum does not consider a more granular split of long term health insurance is required as market risk is the primary risk driver. Furthermore it does not see any need to separate disability and morbidity. **<u>The CFO Forum does not agree with the segmentation of life business into 16 lines to achieve a reliable measurement basis</u>**. Limiting the segmentation to the 4 first level segments in paragraph 3.14 would not jeopardise the accuracy of the best estimate valuation and would be more in line with the approach adopted by companies using internal models. Since CEIOPS clearly states that the segmentation needs not to be the same for the purposes of determining best estimate, risk margin and capital requirements, companies have the opportunity to use a more granular segmentation (beyond the first-level segments) when calculating SCR. The key point is that the above elements (best estimate, risk margin, capital) should not be a function of the level of segmentation chosen but, on the contrary, once their total amounts have been calculated, they can be split into the more appropriate segmentation for other purposes including presentation to the regulator and public disclosures.
Section 3.1.5	**<u>Unbundling should be principle-based and proportionality should apply to all product types</u>** – The CFO Forum does not support the unbundling of components of insurance contracts for measurement of insurance liabilities. Insurance contracts are often composed of a bundle of risks and services. The valuation of those risks and services are often interdependent and the value of the risks and services for the entire insurance contract is not equal to the sum of the values of the separate risks and services. Unbundling such interdependent elements of insurance contracts requires additional judgement and results in a spurious degree of accuracy in the final measurement approach. Insurers should not be required to unbundle insurance contracts unless the components are clearly separable and independent and can be measured reliably. Contracts should be allocated to segments based on the main risk characteristics of the contracts. The CFO Forum strongly supports the view that, subject to the principle of proportionality, contracts covering different non-life and life risks, with one major risk drive, might not require unbundling (see par 3.18 and 3.21 of the CEIOPS Paper).

Comments on Consultation 27-09 Draft L2 Advice on Technical Provisions – Lines of business on the basis of which (re)insurance obligations are to be segmented	
CFO Forum	
Section 3.2 Para 3.21	**<u>Different segmentation will be appropriate for different purposes, although these should be compatible</u>** – The CFO Forum agrees with the proposal that there should not be a fixed segmentation for all purposes and there should be an allowance for companies to use different segmentation for different purposes e.g. Best Estimate (BE), Risk Margin (RM), Solvency capital requirement (SCR), Minimum capital requirement (MCR), and statutory reporting, in order to achieve more accurate and appropriate results. However, it is very important that all requirements are compatible. In Internal Models in particular, insurers should not be constrained in the segmentation they use, otherwise this could go against the requirement to satisfy the "use test".
Para 3.22	**<u>CEIOPS advice relates only to minimum segmentation</u>** – The CFO Forum agrees that this is appropriate. Further CEIOPS advice should not require undertakings to subdivide risks between segments for measurement purposes when: • The level of segregation is disproportionate to the risks being measured. • The level of segregation would require the separation of risks where interdependency is established within contract structures. • The resulting volume of data for each segment is no statistically credible given the inherent volatility of the risks being measured.
Para 3.23	**<u>Undertakings should define the level of granularity appropriate</u>** - The CFO Forum agrees that it will be appropriate for each undertaking to define the homogenous risk groups and the level of granularity most applicable to their business.
Para 3.24	**<u>"Accident and health" should instead be segmented into "Accident" and "Sickness and Health"</u>**- We understand that CEIOPS is still working on the segmentation to use for health insurance (as per the comment in Para 1.4 of the CP), however, we should point out that the proposals of CEIOPS are not in line with Annex 1 of the Level 1 text. The Level 1 text contains two segments, namely "Accident" and "Sicknesss". However, the proportionality principles should obviously still apply and therefore in some cases it may not be appropriate for some insurers to unbundle these categories. **<u>The class "Miscellaneous" should be kept small</u>** - The "Miscellaneous" class should be kept as small as possible. Common parameters for this class are not likely to be meaningful since the content of this class will differ greatly between companies even in the same market.

Comments on Consultation 27-09 Draft L2 Advice on Technical Provisions – Lines of business on the basis of which (re)insurance obligations are to be segmented

CFO Forum

- ⇨ The CFO Forum would request that definition of this class was adjusted so that the "loss of benefits", "insufficiency of income", "business interruption" parts are instead assigned to the line of business where the original loss occurred. This would usually be expected to be property.

"Third-party Liability" should not include any form of motor liability - The CFO Forum would request that the Level 2 advice stressed that "Third-party Liability" does not include any form of motor liability.

Aviation and marine liability should be classed under the respective aviation and marine classes - We note that it states that aviation liability and marine liability should be included within the third-party liability class. We feel that this is not appropriate, due to the differing risk profiles of the business. A more reasonable segmentation would include aviation and marine liability in the respective aviation and marine classes, rather than in the third-party liability class.

- ⇨ The CFO Forum would request that the definition of "3rd party liability" should be amended to not include liability arising from aviation or marine business, which should rather be retained within the aviation and marine class.

Reference should be made to the treatment of non-life annuities - Some non-life insurers have large insurance liabilities in the form of annuities on their balance sheet, and it is artificial to treat them as life business since there are no separate premiums or underwriting connected to the annuities. Furthermore, the nature of the annuity risk is the same regardless of whether they originate from Motor TPL, third-party liability or Workers Compensation and so different treatment of these classes with respect to annuities doesn't make sense, however the nature of annuity risk is different from the risk arising from liability covers. Consequently, annuities are an integral part of the line-of-business from which the claim results and so the CFO Forum believes the CEIOPS advice should clarify that annuities arising from non-life business should be classified under the line-of-business under which the claim arose.

- ⇨ The CFO Forum would request that the paper clarifies that annuities arising from non-life claims are classified under the line-of-business under which the claim arose.

In general, this segmentation appears appropriate- Other than the comments listed above, for the purposes of creating high-level segments for calculating Best Estimates, the CFO Forum supports the non-life segmentation as specified here. Obviously, in order to do the actual BE calculations insurers are likely to split their business more granularly, in order to ensure they are working with homogeneous risk groups.

We would emphasise the point made in 3.1 of the Consultation Paper, that for purposes other than statutory reporting and BE calculations, another compatible segmentation may be more appropriate, e.g. for companies where the marine, aviation and transport category forms a major part of their business, they may wish to split this further into its component parts when calculating the SCR.

Comments on Consultation 27-09 Draft L2 Advice on Technical Provisions – Lines of business on the basis of which (re)insurance obligations are to be segmented	
CFO Forum	
Para 3.25 and 3.26	See section 3.1.3 above.
Para 3.27	**<u>This proposal will require Life insurers to change their current best practices just for Solvency II purposes</u>** – this level of segmentation is not used for internal purposes or other public disclosures. This will, therefore, be inconsistent with the broader objectives of Solvency II to consider management best practice in the supervision of insurers and be inconsistent with the use of internal models in the business. This difference will lead to confusion for the public and will not enhance the transparency. The CFO Forum therefore proposes to use a segmentation which is or will be consistent with how most life insurers are managing their business. No definition is provided for "investment contracts" or "profit participation clauses". The CFO Forum recommends that the same definition is used as applied in IFRS 4, where definitions have already been addressed. Using the IFRS 4 definitions will ensure consistency of segments between regulatory and financial reporting and is a pragmatic basis as companies systems can already identify contracts on the basis of these definitions. The CFO Forum supports the view that contracts should be allocated by the main risk driver and not further unbundled, however, the segmentation into the second level segments proposed should not be required where the differential between the main risk drivers is not consistent with the way the business is managed or is not material in the context of a broader classification.
Paras 3.28-3.33	**<u>The CFO Forum does not support unbundling of contracts where risk are interdependent as this can lead to less reliable measurement</u>** – the entity should consider whether it is more appropriate to unbundle some or all of the aggregated risks for measurement purpose or to evaluate the entire contract as a bundle. Where a contract is clear comprised of a bundle of distinct contracts it would be appropriate to unbundle for measurement purposes unless the additional work is disproportionate to the size and complexity of the separate components. See also section 3.1.5 above.