

# **List of Policy Issues and Options**

## **for the Level 2 Impact Assessment of Solvency II**

**Version 3.0**

*This document contains a revised List of Policy Issues and Options (Version 3) developed by CEIOPS and Commission Services as part of the ongoing work on the level 2 impact assessment for Solvency II.*

*This revised list is an updated version of the list issued with the Call for Advice from CEIOPS regarding its contribution to the level 2 impact assessment and should be read in conjunction with that Call for Advice. The changes made reflect on-going discussions regarding the development of Level 2 implementing measures.*

*Going forward, further changes to the list may be required to reflect on-going discussions regarding the development of Level 2 implementing measures. In this case, an updated version of the list will be published on the Commission's Internal Market Insurance web-site.*

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## A. HIGH LEVEL ISSUES

## 1. Technical provisions – best estimate – risk-free interest rate curve

The value of technical provisions is equal to the sum of a best estimate and a risk margin. The best estimate is equal to the probability-weighted average of future cash-flows, taking into account the time value of money using the relevant risk-free interest rate term structure. The issue is how to derive the risk-free interest rate term structure for the calculation of the best estimate of technical provisions.

The risk-free interest rate is the interest rate that can be obtained – at least in theory - by investing in financial instruments with no default risk. Though a truly risk-free asset exists only in theory, in practice a proxy for the risk free rate may be derived based either on government bond curves or swap curves for the currency of the insurance obligations.

Government securities are usually considered to be risk-free because the likelihood of governments failing to honour these commitments is extremely low in most cases. However, the yields on some government bonds may be subject to market distortions so an investor could earn a higher return with no effective risk in practice or in theory. Where this is the case, an appropriate (upwards) adjustment could be required to reflect this.

The swap curve is the reference curve at which financial institutions commonly value/trade derivatives (including credits). However, insurers are normally unable to earn the swap yield without incurring additional credit risk and charges. Where this is the case, an appropriate (downwards) adjustment is required to reflect this.

Some market participants have stated that the true (liquid) risk free rate lies between the government bond rate and the swap rate in most developed markets. However, views differ on:

- Whether it is better to start from the government bond rate and apply an upward adjustment for “trading distortions” or start from the swap rate and apply a downward adjustment for “credit risk and charges”.
- The most appropriate method to quantify the upwards/downwards adjustment.

On a separate point, information taken from the financial market suggests that the rate is higher if the investor is able and willing to give up the ability to cancel the arrangement at short notice without penalty, or otherwise sell on the asset or obligation. The addition to the rate is referred to as the “illiquidity premium”. However, questions remain on the extent to which insurance liabilities should be considered illiquid for the purpose of Solvency II and, if the liabilities are considered illiquid, the extent to which this should be reflected in the discount rate.

Finally, the method used to calculate the discount rate needs to be consistent between different currencies (e.g. EUR, GBP, SEK, etc.), including those without a government bond or swap market.

Amongst others, the following questions should be addressed:

- Should the relevant risk-free interest rate be determined by starting from swaps or government bonds?
- Should this starting point be adjusted? If so, how should the upwards/downwards adjustment be quantified?
- Should the discount rate include an illiquidity premium? If so, which (re)insurance liabilities should be considered sufficiently illiquid and how should the illiquidity premium be quantified?
- How can the method used to calculate the risk discount rate be extended to derive a figure consistent across different currencies, including those without government bond and swap markets?

<b>Option 1</b>	Use the swap curve
<b>Option 2</b>	Use the government bonds curve
<b>Option 3</b>	Use the swap curve with an adjustment
<b>Option 4</b>	Use the government bonds curve with an adjustment
<b>Option 5</b>	A combination of the previous options

## 2. Technical provisions – risk margin

Technical provisions are equal to the sum of a best estimate and a risk margin.

The risk margin is such as to ensure that the value of technical provisions is equivalent to the amount insurance or reinsurance companies would be expected to require in order to take over and meet the insurance or reinsurance obligations.

The risk margin is calculated by determining the cost of providing an amount of eligible own funds equal to the Solvency Capital Requirement necessary to support the insurance and reinsurance obligations over the lifetime thereof.

The rate used in the determination of the cost of providing the amount of eligible own fund (Cost-of-Capital rate) should be equal to the additional rate, above the relevant risk-free interest rate, that an insurance or reinsurance undertaking holding an amount of eligible own funds equal to the Solvency Capital Requirement would incur to hold those funds.

### *A. Calibration of the Cost-of-Capital rate*

The issue relates to the level of the Cost-of-Capital rate to be retained in Level 2 implementing measures. What would be an appropriate level? How it should be calibrated / updated? Should it be the same for both life and non life businesses?

<b>Option 1</b>	The level of the Cost of Capital rate should be equal to 6%, as specified in QIS4
<b>Option 2</b>	The level of the Cost of Capital rate should be lower than 6%
<b>Option 3</b>	The level of the Cost of Capital rate should be higher than 6%

### *B. Recognition of diversification benefits*

A specific aspect to be analysed is the question as to whether or not diversification effects across lines of business (in the calculation of the underlying SCR) should be taken into account in the risk margin, depending upon the assumptions made about the reference undertaking assumed to be taking over the insurance obligations. If this undertaking is assumed to be well diversified then this would imply that market wide diversification effects could be recognised by all undertakings, even if they are not diversified themselves. Alternatively if the reference undertaking after transfer is assumed to be a mirror image of the insurer transferring the risk, then that insurer could take account of the diversification effects present in its own business. Finally, if the reference undertaking is assumed to be empty before transfer, then no account of diversification effects between lines of business could be taken into account.

<b>Option 1</b>	Assume reference undertaking is well-diversified
<b>Option 2</b>	Assume reference undertaking after transfer is a mirror image of insurer transferring the risk
<b>Option 3</b>	Assume reference undertaking is empty before transfer

### 3. Own funds – quantitative limits for SCR and MCR

In order to ensure the quality of the eligible own funds that cover the SCR and the MCR quantitative limits should be set.

The minimal conditions that those limits must satisfy are the following.

With respect to the SCR the quantitative limits should ensure that Tier 1 own funds constitute more than 1/3 of the total amount of eligible own funds, and that the eligible amount of Tier 3 own funds is lower than 1/3 of the total amount of eligible own funds.

With respect to the MCR the quantitative limits should ensure that Tier 1 own funds constitute more than 1/2 the total amount of basic eligible own funds.

<b>Option 1</b>	SCR: min 1/3 T1 ( $\Rightarrow$ max 2/3 T2) and max 1/3 T3 MCR: min 50% T1
<b>Option 2</b>	SCR: min 50% T1 ( $\Rightarrow$ max 50% T2) and max 25% T3 MCR: min 50% T1
<b>Option 3</b>	SCR: min 50% T1 ( $\Rightarrow$ max 50% T2) and max 20% T3 MCR: min 80 % T1
<b>Option 4</b>	SCR: min 50% T1 ( $\Rightarrow$ max 50% T2) and max 15% T3 MCR: min 100 % T1
<b>Option 5</b>	A combination of the previous options

#### 4. Procyclicality – pillar II dampener

In the event of exceptional falls in financial markets, provision is made in the Directive to allow supervisory authorities to extend the time period within which insurance and reinsurance undertakings are required to re-establish the level of eligible own funds covering the Solvency Capital Requirement.

The issue is what should be the maximum period of time which supervisory authorities can give insurance and reinsurance undertakings to re-establish the level of eligible own funds covering the Solvency Capital Requirement in the event of exceptional market falls.

<b>Option 1</b>	15 months – i.e. 6+3 (in normal circumstances) + another 6 (in the event of exceptional market falls)
<b>Option 2</b>	Between 15 and 24 months – i.e. 6+3 (in normal circumstances) + another 6 to 15 months (in the event of exceptional market falls)
<b>Option 3</b>	Between 24 and 36 months – i.e. 6+3 (in normal circumstances) + another 15 to 27 months (in the event of exceptional market falls)
<b>Option 4</b>	Between 36 and 60 months – i.e. 6+3 (in normal circumstances) + another 27 to 51 months (in the event of exceptional market falls)

## 5. Supervisory reporting – content, form and modalities

Supervisory authorities require (re)insurance undertakings to submit regular information which is necessary for the purposes of supervision. That information should be proportionate, accessible, complete in all material aspects, relevant, reliable, timely and comprehensible.

The intention is to specify the content/form of the information required in order to ensure an appropriate level of convergence in supervisory reporting. This issue relates to the way in which this objective can be achieved in practice through a combination of Level 2 and Level 3 measures. It should be borne in mind that the detailed reporting requirements will be impacted by, inter alia, other Level 2 decisions to be taken by the Commission.

There are a number of factors which have to be considered by supervisors when determining their optimal reporting requirements for both quantitative and qualitative information. The reporting requirements will ultimately depend on a complex interplay of at least the following factors:

- the level of detail, on a Solvency II basis, which the regulator regards as essential for supervision;
- the extent to which the regulator requires the data (or a subset of them) to be subject to external audit or verification;
- how frequently the regulator requires the information (which will ultimately impact the time allowed for submission of the data); and
- the extent to which the quantitative and qualitative data can be harmonised.

Generating mandatory supervisory information can be costly, which needs to be taken into account, especially in the light of the proportionality principle.

Useful background on this issue can be found in CEIOPS Issues Paper CEIOPS-IGSRR-05/07 at

[http://www.ceiops.eu/media/docman/public\\_files/consultations/CEIOPS-IGSRR-05-07%20Policy%20on%20Supervisory%20Reporting%20and%20Public%20Disclosure.pdf](http://www.ceiops.eu/media/docman/public_files/consultations/CEIOPS-IGSRR-05-07%20Policy%20on%20Supervisory%20Reporting%20and%20Public%20Disclosure.pdf)

and

Consultation Paper 24 at

<http://www.ceiops.eu/content/view/14/18/#CP24>).

There is a close interplay between the various factors set out above which will determine the final overall reporting package.

### *A. Content of the quantitative reporting templates in the Report to Supervisors (RTS)*

<b>Option 1</b>	Collect QIS4 template data for supervisory reporting purposes going forward
<b>Option 2</b>	Collect the template data listed in Annex D of the July 2009 Consultation Paper
<b>Option 3</b>	Collect the template data listed in Annex D enriched with the data listed in Annex E of the July 2009 CP

### *A\*. Content of the qualitative aspects of the Report to the Supervisor (RTS)*

<b>Option 1</b>	The RTS on every occasion contains complete information on the subjects specified in section 3.4.3 of the July 2009 CP
<b>Option 2</b>	Undertakings will provide a full report for the first year and thereafter on a frequency to be established by the supervisory authority, depending on the risk profile of the undertaking. In the intervening years, undertakings will provide information only on those topics (specified in section 3.4.3 of the July 2009 CP) where material changes have occurred, or state that no material changes have occurred.

### ***B. Frequency***

<b>Option 1</b>	All data is provided quarterly
<b>Option 2</b>	Core quantitative data is provided quarterly, while all quantitative reporting templates and all qualitative data are provided annually
<b>Option 3</b>	All data is provided annually unless more frequent submission is required in the Directive

### ***C. Level of assurance***

<b>Option 1</b>	All quantitative data are externally audited annually
<b>Option 2</b>	Specific quantitative data are externally audited annually, with the remainder unaudited

### ***D. Reporting format***

<b>Option 1</b>	Standardised reporting formats for all information
<b>Option 2</b>	Free format reporting for all information
<b>Option 3</b>	Quantitative data in a standardised reporting format and qualitative data following a predefined order but in free format

## 6. Public Disclosure – content, form and modalities

Public disclosure of prudential information is seen as a way of harnessing market forces, improving the accountability of firms, and providing information for policyholders. Over time, the standards of public disclosure should increase as ‘best practice’ develops. However, the level of public disclosure (and specifying the circumstances under which public disclosure of information is not required) needs to be determined.

In this regard, the following matters are of special importance:

- Compatibility where appropriate with other reporting rules
- Introduction of proportionate requirements for small firms

When setting out public disclosure requirements, the following dimensions need to be addressed (via a multidimensional analysis, i.e. combining together the possible options for each of the dimensions involved; those combinations will ultimately correspond to the "policy options" for the issue of Public disclosure):

A. Content

B. How public disclosure is achieved

### *A. Content of public disclosure (Solvency and Financial Condition Report – SFCR)*

<b>Option 1</b>	Level of detail of SFCR specified in a generic way (brief description of the information to be disclosed in each item of Article 50(1) of the Directive)
<b>Option 2</b>	Level of detail of SFCR identical to the one requested under the RTS (save as non-disclosure allowed for in Article 52)
<b>Option 3</b>	Level of detail of SFCR specified in a concrete way (definition of the minimum content of the information to be disclosed in each item of Article 50(1) of the Directive)

### *B. How public disclosure is achieved*

<b>Option 1</b>	Specify where the SFCR will be disclosed and its structure
<b>Option 2</b>	Specify where the SFCR will be disclosed but not its structure
<b>Option 3</b>	The location of the disclosure of the SFCR is left to the undertaking, but its structure is specified

## B. LOW LEVEL ISSUES

## 7. Treatment of holdings in participations and subsidiaries

The issue deals with the treatment at solo level of holdings in participations and subsidiaries held by (re)insurance undertakings. These holdings can be classified according to two criteria:

- the relationship with the entity being held, which is:
  - either a “subsidiary” - in the case that the holding implies the exercise of control over the entity (by means of having 50% or more of voting rights or by one of the other means listed in Article 1 of Directive 83/349/EEC), or in the case that the parent effectively exercises a dominant influence
  - or a “participation” - in the case of ownership of 20% or more of voting rights, or in the case of effective exercise of a significant influence
- the nature of the activity carried out by the subsidiary/participation which can be either a (re)insurance entity, or a financial/credit entity or a non-financial entity.

The issue relates to how participations and subsidiaries should be treated in the SCR standard formula, in particular in the calculation of the equity risk sub-module, taking into account the likely reduction in the volatility of the value of those related undertakings arising from the strategic nature of those investments and the influence exercised by the participating undertaking on those related undertakings.

This issue is connected with how holdings in participations and subsidiaries in financial and credit institutions should be treated with respect to the determination of own funds.

Possible different approaches can be adopted to the treatment of holdings in participations and subsidiaries held by (re)insurance undertakings. These approaches will vary depending on the above mentioned criteria – the relationship with the related entity, and the nature of the related entity.

The options below represent combined solutions for the two issues<sup>1</sup>.

<b>Option 1</b>	Apply a differentiated equity stress (compared to the standard equity stress) to all holdings in participations and subsidiaries, including (re)insurance holdings and holdings in financial and credit institutions
<b>Option 2</b>	Apply a differentiated equity stress to all non-financial and (re)insurance holdings in participations and subsidiaries. Apply a different approach to holdings in financial and credit institutions (e.g. deduction/aggregation)
<b>Option 3</b>	Apply a differentiated equity stress to all non-financial holdings in participations and subsidiaries. Apply an alternative approach to (re)insurance holdings, which makes use of the additional information available in these cases to determine the holding's contribution to the overall risk profile of the undertaking. Deduct holdings in financial and credit institutions
<b>Option 4</b>	Apply a differentiated equity stress to all non-financial subsidiaries. Apply a standard equity stress to non-financial participations, which are not subsidiaries. Apply an alternative approach to (re)insurance holdings in subsidiaries and participations, which makes use of the additional information available in these cases to determine the holding's contribution to the overall risk profile of the undertaking. Deduct holdings in financial and credit institutions
<b>Option 5</b>	A combination of the previous options

<sup>1</sup> CEIOPS has set up a task force to deal with this specific issue. Once the work in this area is more developed, the options will be updated.

## 8. SCR Standard Formula – equity risk – pillar I dampener

The SCR standard formula equity risk sub-module includes a symmetric adjustment mechanism ("Pillar I dampener"). The symmetric adjustment is based on a function of the current level of an appropriate equity index and a weighted average level of that index over an appropriate period of time which shall be the same for all insurance and reinsurance undertakings.

The issue to be analysed is what would be an appropriate period of time (expressed in months) over which to calculate a weighted average level of that index.

<b>Option 1</b>	Less than 3 months
<b>Option 2</b>	Between 3 and 6 months
<b>Option 3</b>	Between 6 and 12 months
<b>Option 4</b>	Exactly 12 months
<b>Option 5</b>	Between 12 and 36 months
<b>Option 6</b>	More than 36 months

## 9. SCR Standard Formula – risk absorbing capacity of technical provisions

The Framework Directive requires the calculation of an adjustment for the loss-absorbing capacity of technical provisions to the SCR calculated on the basis of the standard formula.

This adjustment shall reflect potential compensation of unexpected losses through a decrease in technical provisions, and shall take account, in particular, of the risk absorbing effect provided by future discretionary benefits of life insurance contracts, to the extent insurance and reinsurance undertakings can establish that a reduction in such benefits may be used to cover any unexpected losses when they arise (as set out in Article 107).

The issue relates to the methodology to be used to measure the extent to which future benefits which are expected to be paid to policyholders in relation to profit-sharing insurance policies, can be reduced to absorb losses, so that the final result of the SCR formula corresponds to the 99.5% one-year Value-at-Risk measure.

<b>Option 1</b>	A "one-off adjustment" (based on a "k-factor") is applied to the amount of technical provisions (as tested in QIS2)
<b>Option 2</b>	An approach ("kc-factor" approach) where individual reductions of the SCR capital charge are calculated for each possible risk module and sub-modules of the standard formula, are then deducted from each risk module or sub-module SCR charges, and aggregated using the linear correlation matrices (as the one tested in QIS3 and the more refined one tested in QIS4)
<b>Option 3</b>	An adjustment based on the simulation of a single equivalent scenario (as the alternative method tested in QIS4 – see § TS.VIII.C.8)

## 10. SCR Standard Formula – diversification effects

The structure of the standard formula, by aggregating correlated risk modules, enables the recognition of the benefit of the diversification of these risks.

Besides, where appropriate, diversification effects are taken into account in the design of each risk module (i.e. across sub-modules, where applicable) or sub-module (e.g. across lines of business and/or geographical areas).

The calculation of the group solvency capital requirement based on the consolidated balance sheet position of the group will lead to the recognition of further diversification effects amongst the different entities of a group.

The issue relates to the calibration of the various correlation parameters (and, where appropriate, design/calibration of the various interaction assumptions) underpinning the SCR standard formula, as well as their impact on the extent of diversification effects to be recognised at solo and group level. In this context, two sub-issues should be considered:

- A. Calibration of correlation parameters across lines of business
- B. Design and calibration of the approach to geographical diversification in the non-life underwriting risk module

### *A. Calibration of correlation parameters across lines of business*

<b>Option 1</b>	Use QIS4 correlation parameters across lines of business
<b>Option 2</b>	Use lower than QIS4 correlation parameters across lines of business
<b>Option 3</b>	Use higher than QIS4 correlation parameters across lines of business

### *B. Design and calibration of the approach to geographical diversification in the non-life underwriting risk module*

<b>Option 1</b>	No recognition of geographical diversification
<b>Option 2</b>	Recognition of geographical diversification as per QIS4 approach (TS.XIII.B; TS.XVI.B default method – accounting consolidation)
<b>Option 3</b>	Recognition of geographical diversification using a more granular approach than QIS4

## 11. SCR Internal Model – integration of partial internal models

The design of partial internal models should be consistent with the general provisions of the solvency capital requirement so as to allow the partial model to be fully integrated into the solvency capital requirement standard formula. The question that arises is how to integrate partial internal models into the standard formula? What minimum requirements should partial internal models meet in order to be deemed compatible with the standard formula?

<b>Option 1</b>	Integration of partial internal models using only coefficients prescribed by supervisory authorities.
<b>Option 2</b>	Integration of partial internal models using techniques provided by supervisory authorities or – if these are not possible or there is strong evidence that these are inappropriate – dependency structures and parameters provided by the undertaking.
<b>Option 3</b>	Integration of partial internal models using dependency structures and parameters provided by the undertaking or – if these are not approved by the supervisory authority - techniques provided by supervisory authorities.

## C. OTHER ISSUES

## 12. SCR Standard Formula – underwriting risk

The non-life underwriting risk, the life underwriting risk, and the health underwriting risk are modules aggregated together with other modules in order to calculate the basic solvency capital requirement:

- The non-life underwriting risk module reflects the risk arising from the underwriting of non-life insurance contracts, in relation to the perils covered and the processes used in the conduct of business. It is calculated as a combination of the capital requirements for (at least) the following sub-modules: non-life premium and reserve risk and non-life catastrophe risk).
- The life underwriting risk module reflects the risk arising from the underwriting of life insurance contracts, in relation to the perils covered and the processes used in the conduct of business. It is calculated as a combination of the capital requirements for (at least) the following sub-modules: mortality risk; longevity risk; disability – morbidity risk; life expense risk; revision risk; lapse risk; and life catastrophe risk.
- The health underwriting risk module reflects the risk arising from the underwriting of health insurance contracts, following from both the perils covered and the processes used in the conduct of business.

In the options below, when reference is made to "life insurance", health insurance conducted on a similar basis to life insurance is assumed to be also included; similarly, when reference is made to "non-life insurance", health insurance conducted on a similar basis to non-life insurance is assumed to be also included.

The issue relates to the precise method(s) to be adopted in Level 2 implementing measures in order to properly reflect underwriting risk in the standard formula.

### *A. Choice of calculation method for underwriting risk (other than catastrophe risk) arising from non-life insurance obligations*

<b>Option 1</b>	Simulation of the impact of a pre-defined shock on the financial position of the (re)insurance undertaking (Scenario based approach)
<b>Option 2</b>	Closed formula calibrated to a VaR at the 99.5% confidence level over a one-year period (Factor based approach)

### *B. Choice of calculation method for underwriting risk (other than catastrophe risk) arising from life insurance obligations*

<b>Option 1</b>	Simulation of the impact of a pre-defined shock on the financial position of the (re)insurance undertaking (Scenario based approach)
<b>Option 2</b>	Closed formula calibrated to a VaR at the 99.5% confidence level over a one-year period (Factor based approach)

### *C. Choice of calculation method for catastrophe risks arising from insurance obligations*

<b>Option 1</b>	Simulation of the impact of a pre-defined shock on the financial position of the (re)insurance undertaking (Scenario based approach)
<b>Option 2</b>	Closed formula calibrated to a VaR at the 99.5% confidence level over a one-year period (Factor based approach)
<b>Option 3</b>	A combination of the previous options

### 13. SCR Internal Model – use test

The use test requires (re)insurance undertakings to demonstrate that "the internal model is widely used and plays an important role" in their system of governance, in particular with respect to risk-management and decision making processes, as well as their economic and solvency capital assessment and allocation processes. The internal model may be used to cover several aspects of the business, e.g. product pricing and design, investment strategy, capital allocation, etc. How shall the firm demonstrate that their internal models fulfil the use test? What minimum requirements should the governance system of (re)insurance undertakings meet in that respect?

#### Level of application of use test

<b>Option 1</b>	As a minimum requirement, the internal model is to be used at the topmost organisational level of the undertaking. The model is to be used, for instance: <ul style="list-style-type: none"><li>• in setting the risk strategy;</li><li>• allocating risk capital; and/or</li><li>• taking strategic business decisions.</li></ul>
<b>Option 2</b>	The internal model is to be used at all levels of organisation. The areas or processes in which the undertaking has to make use of its internal model are comprehensive and mandatory for all undertakings and include, as an example, the pricing of individual insurance contracts.

## 14. SCR Internal Model – statistical quality standards

The internal model relies on the calculation of a probability distribution forecast. The probability distribution forecast should be based upon current and credible information and realistic assumptions. For that purpose, (re)insurance undertakings may wish to use different sources of information: i.e. internal and external data, as well as expert judgement when data is scarce or it is not reasonable to assume that it provides a good basis for assessing likely future conditions.

The issue relates to how should quality standards for internal, external data and expert judgement be determined.

<b>Option 1</b>	Firms should check the quality and source of all data (internal, external) as well as expert judgement. Firms should agree the use of internal and external data and expert judgement with the supervisor on a case-by-case basis.
<b>Option 2</b>	Undertakings establish their own policy on data quality in line with general supervisory principles. The policy specifies the respective data sources (internal, external) and use of expert judgements, as well as the methods used and the responsibilities for validating the data and expert judgements. Furthermore, the interrelation between data and expert judgement must be addressed. The policy as well as major changes to it, are subject to supervisory approval.
<b>Option 3</b>	Internal as well as external data and the use of expert judgement must be reviewed by an independent third party. Expert judgement may be used in all areas. The use of expert judgement must be well-justified, explained and documented. In particular, when data is available, expert judgement must be reconciled with the data.
<b>Option 4</b>	Internal as well as external data and the use of expert judgement must be reviewed by an independent third party. The use of expert judgement should be kept to a minimum and is only allowed when data is unavailable. It must be well-justified, explained and documented.

## 15. Capital add-ons

Art 37 of the Framework Directive allows supervisory authorities to set a capital add-on when the risk profile of an institution deviates significantly from the assumptions underlying the SCR, whether calculated by the standard formula or by an internal model. Also, a capital add-on may be triggered by a governance deficiency.

The supervisory authority may as a last resort measure impose a capital add-on to increase the SCR of an insurance or reinsurance undertaking.

The capital add-on shall be calculated in such a way as to ensure that the undertaking's overall SCR is in line with the confidence level of 99.5% VaR over a 1-year time-period (Article 37(2)). As a supervisory power the capital add-on can only be applied on a case-by-case basis. The conditions under which a capital add-on may be imposed and the methodologies for the calculation thereof should however be harmonised at level 2 (Article 37 (6)).

Issues to be covered therefore include: definition of a significant deviation and methodologies for the calculation of the capital add-on in accordance with Article 37 (1)(a)(risk profile capital add-on using the standard formula) and Article 37(1)(b) (risk profile capital add-on using an internal model), as well as the establishment of the appropriate timeframe and methodology of calculation of a capital add-on under Article 37(c) (governance deficiency capital add-on).

### ***A. Establishment of the significant deviation and methodology for the calculation of capital add-on in accordance with Article 37 (1)(a) (risk profile capital add-on using the standard formula)***

#### *A.1. Establishment of the significant deviation*

<b>Option 1</b>	Supervisors would take the decision on whether or not to apply a capital add-on on the basis of harmonized criteria established at level 2
<b>Option 2</b>	Supervisors would take the decision on whether or not to apply a capital add-on on the basis of harmonized criteria established at level 2. A harmonised reference value of [5%-15% <sup>2</sup> ] of the overall SCR is established at level 2. This reference value serves as a presumption that the deviation is significant. Supervisors would only consider deviations that exceed this quantitative threshold
<b>Option 3</b>	A harmonized reference value of [5%-15% <sup>3</sup> ] of the overall SCR is determined at level 2. This reference value serves as a rebuttable presumption that the deviation is significant. Supervisors may decide to depart from it (on both ways) based on the application of harmonized criteria established at level 2

#### *A.2. Methodology for the calculation of a capital add-on*

<b>Option 1</b>	CEIOPS to consider options for the methodology of the calculation
<b>Option 2</b>	CEIOPS to consider options for the methodology of the calculation

<sup>2</sup> CEIOPS will consult stakeholders on an appropriate threshold during the public consultation of the consultation paper on capital add-ons this year.

<sup>3</sup> CEIOPS will consult stakeholders on an appropriate threshold during the public consultation of the consultation paper on capital add-ons this year.

***B. Establishment of the significant deviation and calculation of a capital add-on under Article 37(1)(b) (risk profile capital add-on using an internal model)***

*B.1. Establishment of the significant deviation*

<b>Option 1</b>	Supervisors would take the decision on whether or not to apply a capital add-on on the basis of harmonized criteria established at level 2.
<b>Option 2</b>	Supervisors would take the decision on whether or not to apply a capital add-on on the basis of harmonized criteria established at level 2. A harmonised reference value of [5%-15% <sup>4</sup> ] of the overall SCR is established at level 2. This reference value serves as a presumption that the deviation is significant. Supervisors would only consider deviations that exceed this quantitative threshold.
<b>Option 3</b>	A harmonized reference value of [5%-15% <sup>5</sup> ] of the overall SCR is determined at level 2. This reference value serves as a rebuttable presumption that the deviation is significant. Supervisors may decide to depart from it (on both ways) based on the application of harmonized criteria established at level 2.

*B.2. Methodology for the calculation of a capital add-on*

<b>Option 1</b>	CEIOPS to consider options for the methodology of the calculation
<b>Option 2</b>	CEIOPS to consider options for the methodology of the calculation

***C. Establishment of the appropriate timeframe and methodology of calculation of a capital add-on under Article 37(c) (governance deficiency capital add-on)***

*C.1. Establishment of the appropriate timeframe*

<b>Option 1</b>	General criteria established at level 2, with no absolute maximum
<b>Option 2</b>	Maximum period of 6 months that could be shortened according to general criteria established at level 2

*C.2. Methodology for the calculation of a capital add-on*

<b>Option 1</b>	Percentage of the overall SCR established by categories according to a specific grouping of deficiencies
<b>Option 2</b>	Predefined scenarios (cause and effect)
<b>Option 3</b>	Harmonized criteria to be taken into account in determining the amount in addition to cause and effect.

<sup>4</sup> CEIOPS will consult stakeholders on an appropriate threshold during the public consultation of the consultation paper on capital add-ons this year.

<sup>5</sup> CEIOPS will consult stakeholders on an appropriate threshold during the public consultation of the consultation paper on capital add-ons this year.

## 16. Actuarial function

Article 47(1) and (2) of the Framework Directive set out that undertakings should provide an effective actuarial function to undertake a range of specified tasks.

The actuarial function is a new requirement under the Solvency II Directive which each undertaking must have. Although the Level 1 text spells out some of the responsibilities of the function, further guidance is needed to explain how these responsibilities are carried out so that the function is effective.

When further defining the responsibilities of the actuarial function, the following dimensions need to be addressed:

- A. Standards
- B. Scope of the tasks
- C. Reporting

### *A. The standards to be applied by the function<sup>6</sup>*

<b>Option 1</b>	The function should use technical standards developed by CEIOPS on Level 3
<b>Option 2</b>	The function should rely on technical standards that are widely accepted in the industry and the profession
<b>Option 3</b>	The function should rely on European technical standards to be developed and endorsed by a body of representatives of different stakeholders, including CEIOPS

### *B. The scope of the tasks of the actuarial function*

<b>Option 1</b>	It should be left to undertakings to decide on the scope of these tasks individually
<b>Option 2</b>	The general scope of the tasks should be prescribed on Level 2 to some extent

### *C. The reporting of the actuarial function*

<b>Option 1</b>	Require annual reporting with definition on Level 2 of its structure and content
<b>Option 2</b>	Require annual reporting but leave the decision on the details up to the undertakings

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<sup>6</sup> CEIOPS will analyse the option to include a general framework for the implementation of technical standards at level 2 during the consultation and include this option in its IA.

## 17. Supervisory co-operation and co-ordination

Solvency II aims at making group supervision more effective and efficient, in particular by strengthening cooperation, information exchange and coordination amongst EU supervisors. In particular, in the context of group supervision, a number of decisions will have to be taken jointly (by the supervisory authorities concerned), or in consultation with other supervisory authorities, which calls for solid and practical coordination arrangements.

The issue relates to the further specification at Level 2 of the principles set out in the Level 1 Directive, in order to provide for an appropriate legal framework for the following co-operation and co-ordination arrangements:

### *A. Membership of branches to the College*

Supervisory authorities of significant branches and related undertakings shall be allowed to participate to the colleges of supervisors. However, their participation shall only be limited to achieving the objective of efficient exchange of information.

<b>Option 1</b>	Level 2 measures should include binding quantitative thresholds for the determination of significant branches
<b>Option 2</b>	Level 2 measures should include indicative thresholds (quantitative and/or qualitative) for the determination of significant branches

### *B. Frequency of college meetings*

Colleges should regularly meet to discuss the specific activities for the group in order to assure a more efficient and effective group and solo supervision and timely action

<b>Option 1</b>	Level 2 measures shall establish a minimum frequency
<b>Option 2</b>	Frequency of meetings and contacts between supervisors shall depend on the risk-based assessment made by the college, but should take place at least annually