THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

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The Institute of Chartered Accountants in England and Wales (the ICAEW) is pleased to respond to your request for comments on the *Consultation Paper No. 27 Draft CEOIPS' Advice for Level 2 Implementing Measures on Solvency II: Technical Provisions-Lines of business on the basis of which (re)insurance obligations are to be segmented*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours faithfully

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 61/09

CONSULTATION PAPER NO. 27: DRAFT CEIOPS' ADVICE FOR LEVEL 2 IMPLEMENTING MEASURES ON SOLVENCY II: TECHNICAL PROVISIONS- LINES OF BUSINESS ON THE BASIS OF WHICH (RE) INSURANCE OBLIGATIONS ARE TO BE SEGMENTED

Memorandum of comment submitted in May by The Institute of Chartered Accountants in England and Wales, in response to the *Consultation Paper No.27: Draft CEIOPS Advice for Level 2 Implementing Measures on Solvency II: Technical Provisions – Lines of Business on the Basis of which (re) Insurance Obligations are to be Segmented.*

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to comment on *Consultation Paper No.27: Draft CEIOPS' Advice for Level 2 Implementing Measures on Solvency II: Technical Provisions - Lines of Business on the basis of which (re) Insurance Obligations are to be Segmented.*

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

4. The ICAEW's Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues and challenges facing the financial services industry, acting in the public interest and free from vested interests. It draws together professionals from across the financial services industry and from the 25,000 ICAEW members specialising in the sector. This includes those working for regulated firms, in professional services firms, intermediaries, and regulators.

MAJOR POINTS

5. We endorse the CPs objective to keep prescribed segmentation lines to a minimum so as to enable insurers to use the segments they feel most appropriate.

6. We believe that clarification of definitions is necessary for paragraph 1.3 in conjunction with sections 3.1 and 3.2. Given that the technical provision is the sum of best estimate plus a risk margin, if CEIOPS is to give advice on the minimum level of segmentation for calculating technical provisions (as stated in paragraph 1.1), then this implies that the same minimum level segmentation is to be applied to both best estimates and risk margins. Paragraphs 3.1 and 3.2 however recognise that it may be required to use different segmentation for determining best estimates and risk margins. We are not sure how would this impact the minimum level of required segmentation for risk margins.

7. The CP does not fully explain the rationale for the segments selected, which would have been helpful in evaluating whether the segmentation makes sense. It is unclear whether the driver behind the segments selected is consistency with licensing, consistency with other reporting or whether the reserves are considered to have very different characteristics between the categories, whether

the historic data against which regulators will measure the provisions tends to be in these segments or some other reasons.

8. We strongly support the view that given the diversity of products sold and the fact that the undertakings will have the best understanding of their business, undertakings will be best placed to know how to segment the business. If this is the basic premise, however, it could be argued that advice on even a minimum level of segmentation is unnecessary – particularly if the minimum requirement creates practical issues for some undertakings.

9. It is also not clear whether the classes have been driven purely from the regulatory side or whether there has been significant input from insurers. It would be also useful to avoid separating out any classes that may only be likely to have small amounts of premium unless they have very different characteristics.

10. The proposal to apply the same segmentation to each component of technical provisions eg gross premium provisions and gross claim provisions may be problematic in certain instances eg Motor UPR is not readily split between liability and property damage elements. Similar problems may arise in relation to Commercial Package policies and Commercial Fire & BI policies. This suggests that different segmentation should be used for premium and claims provisions.

11. There does not appear to be any recognition that only a small amount of business may be underwritten in a class and that proportionality should allow it to be added into another much larger class for the insurer rather than maintain and retain segmented data for trivial amounts.

12. The unbundling requirement for mixed business appears reasonable as there is allowance for proportionality. It would be helpful if some guidance on the level of acceptable proportionality could be given.

13. Has the feedback for QIS 4 been used to influence the classes selected?

Non Life Insurance

14. The non-life segmentation appears to be driven by Annex I of the Directive which stipulates the authorisation classes. There is also Annex V which stipulates the classes of information to be collected for cross border activities. If we accept that the Directive classes are already locked in it seems a reasonable approach not to create excessive different classes for analysing reserving data to those already being reported upon unless there is a very good reason.

15. There are however a number of segmentations beyond those in Annex I such as the segmentation of workers compensation and also the splitting of motor into liability and other. We note these segments are consistent with the classes required for QIS 4 but is there a real provisioning need for these additional segments.

16. We also believe that in some specific circumstances, some segments for non-life could be too broad eg marine, aviation and transport. If an insurer believes that the segments are too broad and could produce misleading results CEIOPS should allow the insurer to use some sub-segments for certain pre-defined categories. It will also be helpful if CEIOPS could define the sub-segments.

17. It seems logical to split proportional reinsurance in similar classes to direct business.

18. It seems logical to separate non-proportional reinsurance from proportional as they can have very different provisioning characteristics. Why is non-proportional reinsurance only split into the 3 categories of property, casualty and marine, aviation and transport? If these 3 classes are to be retained it would possibly be helpful for consistency to advise which of these 3 reinsurance classes the other classes of direct business should be mapped into if they are underwritten as reinsurance.

Life Insurance

19. The segments into which life business is split are very different to the classes listed in Annex II to the Directive which are required to be reported upon for statistical information on cross border activity. This potentially creates a duplication of analysis which is undesirable. We do however recognise that that the Annex II classes may not be an appropriate segmentation for provisioning purposes.

20. The QIS 4 categories do not appear to provide a direct link to the segments in the CP. In practice will the two naturally fit together or is this an unnecessary duplication of analysis?

21. We understand that for life business a policy can change its characteristics over time and could move from one segment to another. This might raise questions of suitability of the segments as defined by CEIOPS. Further guidance may be required from CEIOPS in such circumstances.

22. We believe that more guidance and examples are needed regarding the requirement not to unbundle where there is one major risk driver. It is not clear how the ‘major risk’ would be identified and applied.

23. It is proposed that life insurance and reinsurance business shall be segmented into 16 lines of business; the 4x4 segmentation model has some attractions:

- The top-level segments identify the three main groups of risk bearers: policyholders, shareholders and shared (participating)
  Most contracts fall readily into a segment; and
- The potential for consistency with IFRS classification of investment contracts and contracts with discretionary participation features.

22. However, limitations or areas requiring further clarification include:

- Treating accepted reinsurance as a first level segment is inconsistent with the treatment of direct insurance, which is subdivided into three top-level segments;

- The definition of contracts with profit participation clauses is also ambiguous: is this intended to be consistency with the IFRS4 definition of a discretionary participation feature, or to include also contracts with complete discretion over crediting rates, such as spread-based business?

23. We believe that there would be practical advantages in aligning the Solvency II segmentation definitions with the IFRS4 definitions.

24. We wonder if CEIOPS has considered whether there could be some significant benefit in splitting life reinsurance beyond the four top level segments for reserving purposes?

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