THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

1 June 2009

Our ref: ICAEW Rep 62/09

Your ref: CEIOPS-CP-30-09

Westhafenplatz 1
60327 Frankfurt
Germany

Secretariat@ceiops.eu

Dear Sir or Madam

DRAFT CEIOPS' ADVICE FOR LEVEL 2 IMPLEMENTING MEASURES ON SOLVENCY II: TECHNICAL PROVISIONS - TREATMENT OF FUTURE PREMIUMS

The Institute of Chartered Accountants in England and Wales is pleased to respond to your request for comments on Consultation Paper No. 30 *Draft CEIOPS' Advice for Level 2 Implementing Measures on Solvency II: Technical Provisions - the Treatment of Future Premiums.* Our comments are provided in the CEIOPS template at Appendix 1.

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

Yours faithfully

Dr Claire Stone ACA
Manager, Audit and Reporting, Financial Services Faculty
T +44 (0)20 7920 8446
E claire.stone@icaew.com

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 62/09

DRAFT CEIOPS' ADVICE FOR LEVEL 2 IMPLEMENTING MEASURES ON SOLVENCY II: TECHNICAL PROVISIONS - TREATMENT OF FUTURE PREMIUMS

Memorandum of comment submitted in June 2009 by The Institute of Chartered Accountants in England and Wales, in response to Committee of European Insurance and Occupational Pensions Supervisors' (CEIOPS) consultation paper no. 30, *Draft CEIOPS' Advice for Level 2 Implementing Measures on Solvency II: Technical Provisions - Treatment of Future Premiums*, published in March 2009.

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Chartered Accountants' Hall
PO Box 433 Moorgate Place London EC2P 2BJ
www.icaew.com

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX DX 877 London/City

INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the Consultation Paper (CP) *Draft CEIOPS' Advice for Level 2 Implementing Measures on Solvency II: Technical Provisions - Treatment of Future Premiums* published by CEIOPS.

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 160 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 750,000 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 Institute'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. It draws together professionals from across the financial services industry and from the 25,000 members specialising in the sector. This includes those working for regulated firms, in professional service firms, intermediaries and regulators.

MAJOR POINTS

5. We disagree with the approach set out in the CP, for reasons we explain below. We believe that an economic approach should be applied to determining the future premiums to be included as part of the contract, namely an appropriate estimate of all premiums associated with a contract. This estimate would be based on supportable lapse assumptions. We do not believe that the insurer should be allowed to include future cash flows that go beyond the existing contract. We recognise that this approach requires the boundary of a contract to be clearly defined, and set out our views at 3.8 of this response.

6. The CEIOPS paper makes reference to the International Accounting Standards Board's (IASB's) standards and its Discussion Paper (DP) 'Preliminary views on insurance contracts'. We would point out that the debate at the IASB has moved on since the publication of the DP in 2007 and we would suggest that the proposals in the CP be revised accordingly.

7. We would strongly prefer Solvency II and IFRS to reach a similar position on the treatment of future premiums. Determining how to measure future premiums is a fundamental issue for both and convergence would bring significant practical and commercial benefits to users and preparers. Users, who are currently bewildered by the variety of metrics and lack confidence in interpreting insurers' accounts, would be able to develop a common understanding of insurers' financial information. As the ultimate destination of the IASB is unknown, and as the role of

standard-setter and regulators do differ, we do not support convergence as an end in itself. Rather, we hope that the principles underpinning the accounting issues in IFRS and Solvency II will be similar, and that this will lead to consistent approaches. Our comments below provide a sensible way forward for Solvency II and bring the proposals closer to what we understand to be the IASB's current position.

RESPONSES TO SPECIFIC POINTS

Paragraph 3.8- 3.9

8. We agree with the recognition and derecognition definitions.

Paragraph 3.10

9. Defining a clear boundary is essential and we recognise that it is not always straightforward. We advocate that a clear principle be developed for determining where the boundary between existing and new contracts be drawn. We would suggest that the boundary of contract should be defined by the cash in-flows that are expected to fall within the contract's term. For these purposes the term of a contract is the shorter of the contract's life and the point, if any, at which the policy can be freely re-priced by the insurer at the individual policy holder level. We support the position taken by the CFO Forum on contract boundaries in their submission to the IASB in December 2008.

10. This is different to the 'guaranteed insurability' approach taken in Quantitative Impact Study 4. We also note that the International Association of Insurance Supervisors (IAIS) has, in a letter sent to the IASB on 7 April, also proposed an alternative to guaranteed insurability which aims to capture the economic substance of contracts by capturing the cash flows under the contract.

11. We do not understand why CEIOPS is promoting a different approach from the IAIS.

Paragraphs 3.14-3.19

12. We advocate an approach which looks at the economic substance of the contract as a whole. Following on from this, where the proposals are inconsistent in their treatment of premiums and liabilities, we would take a consistent approach. We agree that losses from future premiums should be included (3.17) but disagree that profit from the same contracts should be excluded (3.19). The profits arising from future premiums should be included because this gives a more accurate picture of an insurer's position than does only taking into account one aspect of future cashflows. We note that on projects including Revenue Recognition and Leasing, the IASB appears to be increasingly prepared to consider the contract overall.

13. We do not understand why in other areas of Solvency II, CEIOPS and the Level 1 Directive argues strongly for an economic and market consistent approach but for future premiums, a different approach is being proposed.

14. The approach in the CP would practically be very difficult to apply. Whether a future premium gives rise to a profit or loss could vary by individual contract for a portfolio of contracts measured together and may vary for each future premium for a given contract.

15. It is also not clear how the insurer will apply the CEIOPS requirements if expected profits for one contract switches to expected losses from one reporting

period to the other. How frequently will the insurer be expected to assess the outcome of the contract?

16. Finally, we would suggest that if regulators are uncomfortable with expected future profits from future cashflows, they adjust assumptions, the calibration for stress testings or prudential filters to calculate capital requirements, rather than focussing on measurement. For example, assumptions around lapse rates, can be made on a sound basis so that the resulting provisions are not over-optimistic. The advantage of such an approach will be to allow CEIOPS to align more closely with IFRS than will otherwise be the case.

17. The CP looks at renewal considerations (3.14) for contracts. However, if renewal options are to be looked at, so too should the implications of policies which can be cancelled by the policy holder at nil cost as the economic substance of these is identical.

Paragraph 3.20

18. We would find it useful if CEIOPS were to provide more examples of the approach it proposes to take, including for non-life insurance.

Paragraph 3.21

19. We recognise that CEIOPS has concerns about regulatory arbitrage. In our view, an economic approach would help avoid manipulation.

Paragraphs 3.22-23

20. As noted above, we disagree that future premiums belong to the existing contract ‘if and only if the inclusion of the renewals increase the best estimate’ of the provisions. We repeat that the IASB’s 2007 views may not reflect their current position.

Paragraph 3.24

21. We do not agree that the individual contract is, on principle, the most approriate unit of account to determine the boundary of insurance contracts. The business model of insurers sees contracts managed on a portfolio rather than a contract basis, for example as assumptions around lapse and renewal rates are made for portfolios, and we think it makes more sense for the information provided to supervisors to reflect this. On a practical note, many insurers’ systems would not allow them to capture some of the information required at the individual contract level.

Paragraph 3.25

22. We agree that information used should ‘be realistic and based on current and credible information’.

Paragraph 3.26

23. We agree that the risk attaching to certain profitable premiums needs to be taken into account in the Solvency Capital Requirement (SCR). We further note that to exclude profitable future premiums from the liability estimate would introduce an unneccessary difference between SCR calculation and the information reported by the insurer, which in our view should not arise.

Email: claire.stone@icaew.com

www.icaew.com

APPENDIX: ICAEW REPRESENTATION IN CEIOPS TEMPLATE

Comments on Consultation 30-09 Draft L2 Advice on TP - Treatment of Future Premiums	
Name company: Financial Services Faculty, Institute of Chartered Accountants in England and Wales	
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 30-09.	
Reference	**Comment**
General comment	We disagree with the approach set out in the CP, for reasons we explain below. We believe that an economic approach should be applied to determining the future premiums to be included as part of the contract, namely an appropriate estimate of all premiums associated with a contract. This estimate would be based on supportable lapse assumptions. We do not believe that the insurer should be allowed to include future cash flows that go beyond the existing contract. We recognise that this approach requires the boundary of a contract to be clearly defined, and set out our views at 3.8 of this response. The CEIOPS paper makes referemce to the International Accounting Standards Board's (IASB's) standards and its Discussion Paper (DP) 'Preliminary views on insurance contracts'. We would point out that the debate at the IASB has moved on since the publication of the DP in 2007 and we would suggest that the proposals in the CP be revised accordingly. We would strongly prefer Solvency II and IFRS to reach a similar position on the treatment of future premiums. Determining how to measure future premiums is a fundamental issue for both and convergence would bring significant practical and commercial

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Paragraph 3.8- 3.9 ***3.10***	We agree with the recognition and derecognition definitions. Defining a clear boundary is essential and we recognise that it is not always straightforward. We advocate that a clear principle be developed for determining where the boundary between existing and new contracts be drawn. We would suggest that the boundary of contract should be defined by the cash in-flows that are expected to fall within the contract's term. For these purposes the term of a contract is the shorter of the contract's life and the point, if any, at which the policy can be freely re-priced by the insurer at the individual policy holder level. We support the position taken by the CFO Forum on contract boundaries in their submission to the IASB in December 2008. This is different to the 'guaranteed insurability' approach taken in QIS 4. We also note that the International Association of Insurance Supervisors (IAIS) has, in a letter sent to the IASB on 7th April, also proposed an alternative to guaranteed insurability which aims to capture the economic substance of contracts by capturing the cash flows under the contract. We do not understand why CEIOPS is promoting a different approach from the IAIS. We advocate an approach which looks at the economic substance of the contract as a whole. Following on from this, where the

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