

Feedback note - Meeting between Groupe Consultatif and Ceiops on 1 September

Frankfurt 1.9.2010

Presentation of the final draft input on ORSA by the Groupe Consultatif to the CEIOPS subgroup led by Sibylle Schulz

From Groupe Consultatif

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CEIOPS had received the Groupe Consultatif input at the end of July and it had been circulated among the members of this subgroup. Therefore the Groupe could concentrate on highlighting some specific issues. In addition to general remarks we made notes on proportionality, internal models and the role of the actuary. The slides used are included here.

1. Generally on timetables etc.

We have heard from elsewhere of the delay in timetables that we heard today in Frankfurt also. The Commission will give its final proposals on IM's only in May 2011. The IM's will be under consultation from October/November until May. CEIOPS will not start official consultations before the content of IM's is stable so these will begin only in Spring 2011. It gives CEIOPS more time to finalise their thinking. This means that also in ORSA CEIOPS has more time. They will however push the thing forward and have informal consultations with major stakeholders including the GC.

CEIOPS is expecting us to publicise what we have done in ORSA. However, they would like us to wait until they have given out something, that is until Spring 2011.

2. General on GC ORSA

First part of our presentation recouped the history of our efforts on ORSA and briefly tied our work to the context of the directive and IAIS/IAA thoughts on ERM. We also discussed briefly the ideas discussed in one of our previous meetings on the role of capital in ORSA. We got no opposition to our ideas that ORSA of course talks of capital but that does not result in the idea of having this capital up front (instead, the company could have many plans to react over the 3-5 year time period on capital needs). We had emphasis on the main features of ORSA listed on slide 6.

3. Proportionality

We stated, in accordance with our paper, that proportionality should only in very exceptional circumstances apply to the ORSA as a whole. We presented examples on the possible application of the proportionality. We had three aspects to the issue: scale/complexity, stability and level of capital. Criticism came to the idea that a high level of capital could mean that simplified procedures could be applied, an issue that had been discussed earlier in the CEIOPS working group. We elaborated our definition to financial strength embracing both capitalization and record of profitability. We agreed that alone the level of capital cannot trigger the use of proportionality but when these three aspects are used together the level of capital is an important factor. This was clearly a new way of looking at the issue for the CEIOPS working group. CEIOPS interprets proportionality in terms of simplification of methods – we said this is true but it also embraces scope of input and volume of output.

4. Internal models

Elliot presented the ideas in internal models. Some confusion arose as the CEIOPS working group more addressed questions on par. 2.3 instead of 2.5 that was the topic of Elliot. It seems that in this area we have identified issues that are not clear enough even to CEIOPS. Questions in particular arose over what do do when there was no data or model and whether a risk should still be quantified. Our position was

that the risk should still be quantified although we made the point that a model (albeit a subjective / general reasoning model rather than mathematical model) would still need to be deployed to form a view of the capital. There was an interest in what would constitute a verifiable model which we described as being a model with some underlying rationale that could be explained. There was also interest in the ranking of risks and the way in which risks should be evaluated as material or not when there was a lack of data or model. Our point about the need to consider whether a risk was appropriately treated using capital, process or governance seemed to be well received. This resulted in a need to do some additional work on how internal models are extended to ORSA. Especially the question is to discuss the use test of internal models in this area. We described how the the Validation Test and P&L Attributions Test could feed back to the ORSA and provide information of the effectiveness of the internal model in explaining the risks the company is facing. CEIOPS were quite keen to understand how an internal model should be used to produce information for the ORSA if the ORSA had been used to design the internal model. This potentially leads to a circular reference with the ORSA designing the Internal Model and then the Internal Model being used for the ORSA which is where some confusion arose. We were asked to do some additional thinking in this area.

5. Role of the actuary

Seamus introduced our ideas on the role of the actuary. In addition to the actuary being the most beautiful creature on this side of the pearly gate Seamus presented the actuarial skills essential to perform an appropriate ORSA. In addition to this actuaries are needed to safeguard the quality of the ORSA process. This would mean doing something like a due diligence of one's own business where at least the actuarial function should not be unhappy with the ORSA.

CEIOPS said that many things we say will be in their statements on the actuarial function and risk management and they are thinking of how to do things without the need to duplicate these same issues in different parts. We agreed that the input to the ORSA should draw upon the involvement in ongoing risk management

6. Conclusion

The CEIOPS working group was clearly thankful for the work done. They continue their work and said that even in areas where they do not take material from our work they have got ideas from us. When asked what would be the most important issues from our part we stated

- the main features on slide 6,
- links to the actuarial function and risk management, and
- proportionality issues, especially the three aspects of complexity, stability and financial strength.