Mr Donncha Connolly
Head of Retail Insurance Supervision
Central Bank of Ireland
P O Box No. 559
Dame Street
Dublin 2

28th January 2011

Dear Mr Connolly,

Re: Requirements on Reserving and Risk Governance for Variable Annuities

The Life Committee of the Society of Actuaries in Ireland has reviewed the "Requirements on Reserving and Risk Governance for Variable Annuities" ("Requirements") issued by the Central Bank of Ireland ("Central Bank") in December 2010.

We believe it would be useful to those of our members who will be carrying out work prescribed in the Requirements if certain elements could be elaborated upon. For this purpose, could you please clarify some points, as set out below?

1 Introduction

"This letter set out qualitative disclosure requirements with respect to year end 31 December 2010. This paper formalises the requirements of that [8 November 2010] letter for future periods . . . "

We note that, while the letter of 8 November 2010 and Section 6 of the Requirements have significant similarities, they are not identical.

(a) Can you please confirm whether the requirements in Section 6 apply in respect of year end 31 December 2010 only to the extent that they were already set out in the letter of 8 November 2010 (i.e. additional or differently articulated requirements set out in Section 6 apply only in respect of future periods)?

(b) Does the above reference to "qualitative disclosure requirements" mean that, for year end 31 December 2010, the various quantifications required under the 8 November 2010 letter and section 6 of the Requirements are required only for the purposes of the Actuarial Report – i.e. the technical provisions and solvency reserves as at that date should be determined in accordance with the regulatory requirements that applied immediately prior to the 8 November 2010 letter being issued?

2 Requirements on Reserving and Risk Governance

2.1 Applicability

"*All insurance and reinsurance undertakings authorised to transact life insurance and reinsurance business in Ireland are required to consider and report whether they believe they are transacting VA business and on the level of such activity.*"

(a) The duplication between Section 2.1 and Section 3.1 a) has caused confusion as to whether *all* undertakings or *only VA* undertakings must make a declaration on whether they are transacting VA business. Can you please clarify? (Incidentally, it appears, from conversations that some of our members have had with their employers / clients, that not all insurance undertakings are aware of the Requirements).

(b) If an undertaking makes a declaration in good faith that it is not transacting VA business, presumably it is not required to comply with the Requirements unless and until the Central Bank rebuts the declaration. Can you please confirm?

(c) Is it the Central Bank's intention that the Requirements will expire when the Solvency II requirements (including any additional requirements that are issued as a result of the current consultation on EIOPA Consultation Paper CP83) are implemented?

3 Variable Annuity Business

"The undertaking must make this submission to the Central Bank no later than 31 March 2011. The Central Bank will in due course confirm the undertaking's assertion or engage in discussions with a view to resolving differences."

(a) If an undertaking makes a submission in good faith that it has no investment guarantee business in force (Section 3 b)) or that it should not be classified as a VA undertaking (Section 3 c)), presumably it is not required to comply with the Requirements unless and until the Central Bank rebuts the submission. Can you please confirm?

(b) In relation to Section 3 c) ii., would it be acceptable for undertakings to refer to the guidance in EIOPA Consultation Paper CP83 this regard?

4 Independent Oversight

(a) Is independent oversight (whether through Independent Non-Executive Directors or Peer Review) required for the 2010 year end Actuarial Report, or is it required only from year end 2011 onwards? It appears, from the Introduction and Section 2.4, that only Section 6 of the Requirements applies as at 31 December 2010.

If independent oversight is not required for the 2010 year end Actuarial Report, the next four questions may be ignored.

(b) *"Until such time as the transitional period ends ..."*

Presumably this is a reference to the date of 31 December 2011 by which undertakings must comply with the provisions of the Corporate Governance Code relating to board composition (Section 5.1 of the Code). Therefore, does this Section of the Requirements imply that the 2010 year end Actuarial Report must be subject to independent consultant peer review (if the undertaking does not meet the requirements of the Code relating to board composition), while subsequent year end actuarial reports will be subject only to the oversight of the INEDs?

(c) Can you confirm, please, that if an undertaking has one or more INEDs with relevant competencies in place and believes that it meets the requirements of Section 5.1 of the Code before submission of the year end 2010 Regulatory Returns, peer review of the year end 2010 Actuarial Report by an independent consultant is not required?

(d) Consider the case of a reinsurance undertaking where the Signing Actuary is an external consultant who has *"no other involvement in the management or design of the products or any hedging process"*. May the peer review be provided by another actuary or suitably qualified person within the consultancy that employs the Signing Actuary, or must it be provided by a different consultancy?

(e) In relation to the scope of the peer review, is it permissible for this to be limited to those parts of the Actuarial Report that relate to VA business, where these are clearly identifiable?

5 Minimum Capital & Reserves Standards

(a) *"The allocation between [solvency reserves and technical provisions] is of lesser importance."*

(i) Does this mean that the Central Bank will accept any reasonable split between technical provisions and total required solvency margin in the completion of regulatory return forms? Is it acceptable, for example, to say that CAR on a CTE90 (or CTE95) basis = Technical Provisions + 150% * Required Solvency Margin, for an undertaking currently expected to hold 150% of the Required Solvency Margin?

(ii) If, for the same undertaking, technical provisions are, say, €100M and 150% * Required Solvency Margin is a further €100M, but CAR on a CTE90 (or CTE95) basis is, say, €300M, is the undertaking required to increase the technical provisions such that Technical Provisions + 150% x Required Solvency Margin = €300M? Or may the undertaking leave the technical provisions at €200M in the regulatory returns and advise the Central Bank by separate correspondence regarding the higher CAR computation and the adequacy of assets to cover the higher amount?

5.1 Minimum CAR

(a) *"However, undertakings must ensure that the following minimum standard is applied to the calculation of reserves included in regulatory returns:"*

Presumably this applies only to the calculation of reserves in respect of VA business that the undertaking has written and the CAR should be the normal reserve plus required minimum solvency margin for any other business on the undertaking's balance sheet. Can you please confirm?

(b) *"For business written on or before 31 December 2010, the reserves must be calculated using an appropriate stochastic model . . . subject to a minimum of a CTE 65 basis plus the required solvency margin plus resilience test. . . "*

(i) Can you please confirm that "reserves" here means "CAR"?
(ii) For a reinsurance company, when is "business written"? Is this defined by the start date of the reinsurance treaty, or of the underlying policies?
(iii) Where a reinsurance treaty has a commencement date earlier than 31 December 2010 but it is not finalised and signed by both/all parties until after that date, may the reinsurance company use the CTE90 capital standard?
(iv) Presumably, for a direct writer, business is deemed to be written with effect from the policy start date, is that correct? How should undertakings treat policies that have an effective start date in 2010 but which are issued in 2011?
(v) Whilst the CTE risk measure is specified, the Requirements are silent on the projection term for the calculations. Is it intended to be a full policy lifetime projection?
(vi) Can you confirm, please, that the resilience test applies only on the CTE65 basis, and not on the CTE90/95 bases?
(vii) No specific resilience test has previously been prescribed for reinsurers. Is the basis per the Central Bank's "Dear Appointed Actuary" letter now required for reinsurers?

(c) *"Equivalent Value at Risk ("VAR") measures may be used"*

(i) What constitutes an equivalent VAR measure? Presumably VAR95 is not acceptable as a replacement of CTE90, for example, but what evidence must be presented to support a given VAR measure?
(ii) How frequently must the equivalent VAR measure be revalidated?
(iii) Is it permissible to use a 1-year VAR measure as opposed to the (presumably) lifetime CTE measure specified?

6 Actuarial Report

(a) *"Analysis and justification of basis risk (where necessary, this should be included in technical provisions)."*

Why should this be included specifically in the technical provisions? This seems to be inconsistent with the statement in Section 5 that the split between solvency margin and technical provisions is "of lesser importance". Is the core requirement that the CAR take account of this factor?

(b) *"If any of these pose significant risk that is not covered in the CAR, then the CAR must be increased to an appropriate level."*

This appears to contradict the statement in the Introduction that the Section 6 Requirements (as first set out in the Central Bank's letter of 8 November 2010) are "qualitative disclosure requirements". Is the above statement intended to apply in respect of year end 31 December 2010, or only in respect of subsequent year ends?

(c) *"the undertaking must commission a report from the Signing Actuary or Appointed Actuary as appropriate which covers and quantifies all of the above"*

Given the relatively limited and point-in-time role of the Signing Actuary up to now, is it mandatory that this report is provided by the Signing Actuary, or may it be provided by another suitably qualified individual?

6.3 Model of Sufficient Prudence

"undertakings must have regard to the Internal Model tests as prescribed under Solvency II Directive (2009/138/EC)"

To what extent are these "tests" fully prescribed and finalised? Should undertakings refer to the current draft of Level 2 Implementing Measures for the 2010 year end?

6.6 Operational and Model Risk

"Undertakings must analyse and quantify in the Actuarial Report the following causes. . . "

The Requirements acknowledge the possibility of "a more high-level approach" initially, moving over time to greater sophistication. Is it permissible for the year end 2010 Actuarial Report to be completed on the basis of a purely qualitative approach in relation to sub-section 6.6, with no substantive quantification?

6.8 Behavioural Risk and Dynamic Lapsations

(a) *"The Central Bank has recently become aware of the possibility of hedge fund activity in the secondary VA market. The impact of such activity must be reflected by the undertakings in the derivation of lapse and premium cessation rates."*

What if the undertaking has no evidence of viatical activity? May the actuary rely on robust lapse investigation and monitoring, irrespective of underlying cause?

(b) *"The impact on the hedging program of changes to persistency assumptions also needs to be quantified".*

Is this entirely separate from reserving and capital - is this instead a requirement for a perspective on actual hedge-effectiveness as observed within the hedging program?

(c) Where, in accordance with Section 5.1 c), direct writers do not make any allowance for lapses, presumably Section 6.8 does not apply other than to consider whether dynamic lapse may produce higher capital requirements than zero lapses?

6.10 Solvency II

(a) This Section was not included in the Appendix to the Central Bank's letter of 8 November 2010. Can you please clarify whether this Section applies in respect of year end 31 December 2010, or subsequent year ends only?

(b) What are the requirements for undertakings with a mixture of VA and other business? Will full Solvency II figures be required for all of the undertaking's business or only for the VA business, where it is possible to separate out the latter?

(c) *"The Central Bank hereby requires that undertakings submit . . . What technical provisions and Solvency Capital Requirement ("SCR") of the undertaking would be under Solvency II, both standard formula and internal model. . . "*.

  (i) If an internal model is to be prescribed for VA writers, is the standard formula basis relevant at all?
  (ii) What figures should an undertaking present if its internal model is still under development?
  (iii) Should the undertaking apply the parameters that were used in QIS5 when completing the year end 2010 report?

(d) *"If the SCR required under either method is more than under Solvency I, analysis and justification of the reasons why and a timetable for bringing up the strength of reserves to Solvency II standards"*

Is it the intent here that justification is required if Best Estimate Liabilities + Risk Margin + Solvency Capital Requirement is greater than CAR?

Given the timescale within which the new requirements relating to year end 31 December 2010 must be met, an early response to the above questions would be very helpful.

Many thanks.

Yours sincerely,

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Yvonne Lynch
Director of Professional Affairs

c.c. (by email): Tony Jeffery, Deputy Head of Retail Insurance Supervision