

**Comments Template on
Discussion Paper on the review of specific items in the Solvency II
Delegated Regulation**

**Deadline
3 March 2017
23:59 CET**

Name of Company:	KPMG	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ Do not change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇒ Leave the last column <u>empty</u>. ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph or a cell, keep the row <u>empty</u>. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. <p>Please send the completed template, <u>in Word Format</u>, to CP-16-008@eiopa.europa.eu</p> <p>Our IT tool does not allow processing of any other formats.</p> <p>The numbering of the questions refers to the discussion paper on the review of specific items in the Solvency II Delegated Regulation.</p>		
Reference	Comment	
General Comment	<p>We appreciate the opportunity to comment on the above Consultation Paper. We have consulted with, and these comments represent the views of, the KPMG network.</p> <p>We are focusing on those aspects that we consider of special importance. Please consider our silence on other questions not as an implicit agreement.</p> <p>Please contact Joachim Kölschbach +49 (0)221 2073 6326 if you wish to discuss any of the issues raised in this letter.</p>	
Q1.1		

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Q1.2		
Q1.3		
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Q1.10		
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Q1.25		

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Q1.26		
Q2.1		
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Q2.7		
Q2.8		
Q2.9		
Q2.10		
Q3.1		
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Q3.11		
Q3.12		
Q4.1		
Q4.2		
Q5.1	The definition of $FP_{(future,s)}$ should be changed to exclude only « the premiums to be earned during	

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	<p>the following 12 months » for the following reasons: This new definition will close an artificial gap in the volume measure (e.g. when doing SCR calculation for the 31 December 2020 and considering new business signed in October 2021 with coverage period starting 1 January 2022). It is easier to understand and allows for a closer modelling of the risk defined in Article 101 of the Solvency II Directive.</p>	
Q5.2		
Q5.3		
Q5.4		
Q5.5	No	
Q5.6		
Q6.1		
Q7.1		
Q7.2		
Q7.3		
Q7.4		
Q7.5		
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Q7.10		
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Q7.12		
Q7.13		

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Q8.1		
Q8.2		
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Q8.8		
Q8.9		
Q8.10		
Q8.11		
Q8.12		
Q9.1		
Q9.2		
Q9.3		
Q9.4		
Q9.5		
Q10.1	<p>In our view, the Lee Carter model is a very useful academic model, but there are significant practical limitations for applying it to produce reliable mortality rates, and the uncertainty therein, for a long projection period. The limitations are described in academic literature :</p> <ul style="list-style-type: none"> • The LC model implies perfect correlation between mortality improvements for different ages, as there is only one period parameter. • The improvement factor B(beta) is fixed in time, and therefore also determines the volatility in future mortality rates. Historically, improvement rates have been lower at high ages, which means that predicted uncertainty in future death rates will be lower at high ages, in contrast to observed variability. 	

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	<ul style="list-style-type: none"> • The c parameter in the ARIMA(0,1,0) model is effectively determined by the first and the last observation t, which makes the fitting sensitive to the calibration period. • A jump-off bias can occur because the estimated mortality rates for the last year do not correspond to the observed rates. This can be corrected using reduction factors. • For different ages, the forecasted mortality rates do not necessarily have same (shifted) behaviour, which means that long-term projections can become implausible. <p>The other model described in the consultation (developed by the MRC) is more robust for assessing future mortality and the uncertainty therein. If a quantitative model is preferred over scenario analysis, this model might form a better basis. The advantage is that it would allow country specific parameters to be aligned with differences in uncertainty in different countries.</p> <p>Based on the high percentile used for SCR calculations (99.5%), using a scenario approach for the main mortality causes might lead to a more robust estimate of the parameters needed for the SCR calculation. It might be worthwhile to consider this as an alternative to the traditional stochastic forecasting models like Lee Carter.</p>	
Q10.2		
Q10.3	<p>This is worthwhile to consider. Mortality causes in 20 years from now may be quite different from causes today. Therefore it would make sense to consider the most important death causes separately, and use an expert opinion about the mortality trend in some of these causes.</p> <p>The appropriate way to do this can be the use of ‘net mortality rates’ and ‘crude mortality rates’, as described in : Bowers et al.; Actuarial Mathematics; The Society of Actuaries; 1997.</p>	
Q10.4		
Q10.5	<p>In case specific death rates for specific death causes are needed, a useful data set might be offered by the World Health Organisation.</p>	
Q10.6		
Q10.7		
Q10.8		

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Q10.9		
Q10.10		
Q11.1		
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Q11.6		
Q11.7		
Q11.8		
Q11.9		
Q12.1		
Q12.2		
Q12.3		
Q12.4		
Q12.5		
Q12.6		
Q12.7		
Q13.1		
Q13.2		
Q13.3		
Q13.4		
Q13.5		
Q13.6		
Q14.1	No, we have not experienced any ambiguities.	
Q14.2		

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Q14.3		
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Q14.10		
Q14.11		
Q14.12		
Q15.1		
Q15.2		
Q15.3		
Q15.4		
Q16.1	The nature of the activities, similar to what is done for the definition of ancillary services undertakings. For instance when the nature of the activities is close to insurance activities, a different treatment may be justified from when the nature is completely different.	
Q16.2		
Q16.3		
Q16.4		
Q16.5	From an economic / risk view the look-through approach should always be allowed. It is always the theoretically best solution.	
Q16.6		
Q16.7		
Q16.8		
Q16.9		

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Q17.1	Yes, back-testing as shown in the discussion paper shows that using a relative shock (and not stressing negative basic risk-free interest rates) is underestimating the 99.5% VAR for downward shocks	
Q17.2	<p>We are wondering how the current minimum upward shock has been calibrated. The approach of an absolute and fixed 1% minimum downward shock might lead to misleading outcomes. A key issue is the question what could be an absolute minimum level («absolute minimum floor») for interest rates from the perspective of European authorities taking into account that extreme negative interest rates would lead to an extreme increase of cash-holding in the insurance sector. Based on information received from insurance companies there are expectations that costs of cash-holdings and transportation will not be much higher than 40 bps per annum.</p> <p>A simple solution is to calibrate the minimum downward shock in line with the calibration of the minimum upward shock and to check against the mentioned absolute minimum floor.</p>	
Q17.3		
Q17.4		
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Q17.8		
Q17.9		
Q17.10	No preference	
Q17.11		
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Q18.1		
	<p>IAS 12 (and the supporting Basis for Conclusions) gives some guidance on future investment yields which is relevant. Therefore, we consider there are adequate safeguards in IAS 12 to prevent inappropriate DTA valuations. We suggest that EIOPA should seek to rely on the work of the IASB in this respect.</p> <p>For example, the IAS 12 material includes a presumption that an investment in single equity-like investments cannot be recovered at more than carrying value. In some cases, it may be possible to rebut this presumption – for example, where there is a diversified portfolio of equities.</p> <p>The notes to part of the EIOPA Guidelines on tax state that it should be assumed that an asset cannot be recovered for more than its carrying value. This is inconsistent with IAS 12 and reality. For example, consider a Government bond with coupon rate of 1% and say the market risk free interest rate was 1.5%. The value of that bond would be below its par value. But it would be clear that the bond could be sold or redeemed, in future, at more than its current fair value. In some jurisdictions these future increases in FV would be taxable profit. We suggest the Guidiedlines are modified to bring them into line with IAS 12.</p>	
Q18.2		
Q18.3		
Q18.4	<p>For the calculation of LAC DT, only fiscal profits and losses can be taken into account, as only the tax situation can represent the amount of tax benefits to be realised over time.</p> <p>As long as economic profits do not lead to taxable income, no tax benefit will arise.</p> <p>In some cases, forecasting economic profits may be possible as a simplification but this would need to be justified as a good approximation. This would be appropriate if the only differences between economic and fiscal profits were ones of timing and the tax law allowed unused tax losses to be carried forward and/or carried back.</p>	

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	<p>One part of future economic profits may be the release of the SII risk margin. There may be similar items in forecasts of future IFRS profit once IFRS 17 is implemented. We consider that EIOPA and national regulators should focus on the credibility of evidence used to support future profits.</p> <p>In some cases, insurers have made a strategic decisions to stop writing certain capital intensive products with high risk margins and focus on other products with lower risk margins. In such cases, an insurance undertaking should be able to reliably forecast the extent to which risk margins will reduce over say a 3 to 5 year business planning time horizon. Once a reliable track record has been established, we would see no conceptual difficulty in using such forecasts to support DTAs.</p>	
Q18.5	<p>The SII framework follows the « Going Concern Assumption » not a « gone concern » view. The individual impact of adverse stresses on the individual company’s strategy needs to be taken into account. After a catastrophe stress the market opportunities, e.g. in the reinsurance industry, might get better and impact overall pricing cycles.</p> <p>Therefore a definition of or guidance on the definition of new business could be helpful (for example whether the planned renewal of existing business is to be considered as new business or just an increase of business from new clients). For instance to what extent can new business be reasonably calculated (eg with respect to new products , should the stage of development be considered) ?</p>	
Q18.6		
Q18.7	<p>Consideration of increasing uncertainty makes sense. In this context, differentiation based on different lines of insurance may be reasonable :</p> <ul style="list-style-type: none"> • Are there different possible projection horizons for long term (e.g. life) and short term (e.g. car insurance) business or are they to be treated similarly ? • Could actuarial projections, especially for long-term life business, be the basis for a longer planning horizon than the usual planning cycle of an undertaking ? 	

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Q18.8	<p>If there is to be a rule about time horizon, it should be noted that there is a distinction between :</p> <p>(i) relying on an item on the SII balance sheet which takes 40 years to crystallise as a tax profit (in such a case there is no risk or subjectivity if such profits are used to support a loss) and</p> <p>(ii) forecasting future profits from new business, investment margins or releases of margins which are subjective and the business planning horizon is relevant.</p> <p>Item (i) is effectively the offset with a DTL which takes 40 years to crystallise.</p>	
Q18.9	<p>Under IAS 12 there is no explicit limitation on the time horizon, nor does it set a cap. We recommend that reference to the IAS 12 framework is retained as it is an internationally recognised framework for deferred tax and includes a number of safeguards against inappropriate deferred tax balances (for example strict rules on using DTLs to support DTAs, rules for unremitted earnings, presumption against valuing DTA in companies with a history of losses).</p> <p>Retaining this link helps ensure quality and consistency as it builds on guidance familiar to insurance undertakings and auditors. It also avoids the need for EIOPA to have their own detailed rules on tax. Departing from this and applying a simplified approach could be inappropriate in complex cases. We do not think DTAs should be prohibited as that weakens the link to IAS 12 and weakens the framework.</p> <p>The SII balance sheet is an economic balance sheet and should take an economic view of the value of DTAs. So that means allowing DTAs to have a value above zero and not imposing artificially low assumptions for investment yields. We understand that regulators will want to be cautious and therefore the current requirement for credible evidence is appropriate.</p> <p>We note in practice that many companies do not value DTAs in full and this is in part due to not having credible profits projections. Therefore the current rules are effective in preventing speculative valuation of DTAs.</p> <p>We do not consider setting the LAC DT to the net DTL on the balance sheet as a rule being a</p>	

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	reasonable reduction in the subjectivity of calculations. There may be strong indications for the availability of future profits to support the recoverability of LAC DT (also there are tax effects from loss carry backs in some jurisdictions).	
Q18.10		
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Q21.1		
Q21.2		
Q21.3		

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Q21.4		
Q21.5		
Q21.6		
Q21.7		