Comments on Consultation 32-09 Draft L2 Advice on TP – Assumptions about future management actions	
Name company: CEA	
Reference	**Comment**
Introductory remarks	The CEA welcomes the opportunity to comment on the Consultation Paper (CP) No. 32 on TP – Assumptions about future management actions. It should be noted that the comments in this document should be considered in the context of other publications by the CEA. Also, the comments in this document should be considered as a whole, i.e. they constitute a coherent package and as such, the rejection of elements of our positions may affect the remainder of our comments. These are CEA's views at the current stage of the project. As our work develops, these views may evolve depending in particular, on other elements of the framework which are not yet fixed.
Key comments	**Flexibility and judgment is essential in the modelling of management actions** - For the purposes of calculating Best Estimates and the SCR it is important to have an understanding of the management actions that the insurer is expecting to use, however these should not overwrite the reactions of the insurer under exact scenarios where the protection of the policyholder and the ongoing viability of the insurer are important considerations. The insurer may have to react to each situation in an ad-hoc manner and this should not be restricted by the assumptions that it has used in determining its Best Estimates. Furthermore, it is important that management actions are defined in terms of principles only. Algorithms can be useful in terms of modelling but an over-reliance could be dangerous. Algorithms should be under regular review and it should be possible to amend these without excessive controls. It is also essential that insurers are able to apply proportionality in the use of management actions. In particular, the modelling of management actions should be weighed against the expense of setting up systems and the effect on capital requirements. Finally, it may not be appropriate to require the Board to sign off all management actions used in the best estimate calculations and particularly not the case that the Board should approve mathematical algorithms.
General Comments	**Management actions should be considered in the context of governance and risk management** – The paper doesn't sufficiently capture the links between the management actions assumed in the calculation of technical provisions and the issue of governance and risk management. A key consideration should be how the management actions are integrated in their risk management processes, i.e. how does the (re)insurer manage their risk and what does their risk management process assume would be the action taken under certain scenarios.

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	Links to other CPs - It is important to consider this topic in line with the requirements for best estimate methods (CP26) and governance issues (CP33). The links to CP26 and CP33 need to be taken into account in this CP. **Dynamic hedging strategies should be fully reflected in management actions** - If an undertaking uses dynamic hedging strategies, it is important that these are taken into account in the assumed management actions of the undertaking. There should not be a requirement to consider only those assets which are currently held under the hedging strategies. Rather, if the management plans to roll-forward these strategies then they should be taken into account in the Technical Provisions. Please see our comments on this issue in CP 31. **The scope of the effect of future scenarios may affect the management actions used by the undertaking** – The response of an undertaking to a particular future event may differ depending on whether this event hits the individual undertaking only or whether it hits the whole market at once. In particular, competitive considerations would be different in each case. This does not appear to be explicitly considered in this paper.
Para 3.2	The CEA strongly supports the allowance for management actions in the calculation of best estimate liabilities and capital amounts as this is essential in a risk based economic approach. **“Market value adjustments” are not clearly defined** – This term is only used in some Member States. Therefore, its use may lead to misunderstanding. ⇨ The CEA would request more explanation of the statement “the way in which a market value adjustment is applied”. **“Policyholder expectations” are not clearly defined** –In some Member States this term could have varying interpretations. ⇨ The CEA would request clarification of the term “policyholder expectations”.
Para 3.3	**Changing charges on unit-linked or index-linked business is too narrow a definition for management actions** - The ability to allow for management actions should apply to all types of insurance business, not just unit linked or index-linked business e.g. it should also apply to universal life business, reviewable term assurance business and some reinsurance contracts.

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Para 3.6	**Management actions should be allowed over the course of the scenario** - The CEA believes that management actions should include all possible actions, including those relating to asset management strategy. The CEA disagreed with the treatment in QIS4 to disallow actions taken over the course of the scenario. The CEA is pleased to see that CEIOPS' advice in Para 3.25-3.36 does not include this disallowance. However, the CEA is concerned by the statement made in Para 3.25 of CP31 that the change in financial conditions should be assumed to occur instantaneously for the purposes of calculating the SCR, which effectively excludes any benefits from dynamic asset management strategies (e.g. delta hedging) and results in a stress more onerous than the 99.5th 1-year criteria (as it is applied instantaneously rather than over 1 year). Furthermore, this assumes that undertakings have a lack of reactivity and it could result in certain products, such as variable annuity products, being unnecessarily expensive or unattractive. This would especially be the case if this approach were to apply to internal models as well as the standard approach. ⇨ The CEA suggests that the paper makes it clear under the Level 2 implementing measures that companies should be allowed to assume management actions can be taken over the course of the scenario.
Para 3.9	**The allowance for management actions should be subject to proportionality** - Often allowing for management actions would be expected to reduce the Technical Provisions. As such, there should be flexibility surrounding the requirement to allow for them and in turn to develop complex calculation systems, especially if simpler alternative calculations methods could give acceptably accurate results. Furthermore, when a (re)insurer is allowing for management actions, a decision to include **all** possible future management actions in the model could be overly ambitious. ⇨ The CEA suggests that "*need to take account*" is changed to "*may take account*".
Para 3.10	In line with our comments to Para 3.9 above: ⇨ Suggest that "*analytical or deterministic approaches should take account*" is changed to "*analytical or deterministic approaches may also take account*".
Para 3.12	In line with our comments to Para 3.9 above: ⇨ Suggest "*which should*" is changed to "*which may*".

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	The principle of proportionality needs to be taken into account in the allowance for management actions - The CEA agrees with the general approach, i.e. that management actions should be objective, realistic and verifiable subject to this being applied in a proportionate manner.
Para 3.13	See comments to Para 3.27
Para 3.14	See comments to Para 3.28
Para 3.15	**Realism may change due to differences in new business** - *"Realism"* should not be interpreted too literally, i.e. the reality may be different due to new business in-flow and the presence of more liquidity deriving from future premiums, in a real portfolio the duration gap may be compensated by the liquidity due to premium in-flow. ⇨ The CEA would request that the following addition was made to the end of this paragraph: "*…taking into account the fact that new business over the period under which management actions are assumed may be different to expected*."
Para 3.16	See comments to Para 3.32
Para 3.18	**Internal consistency requirements should be applied in a proportionate manner** - It is reasonable to assume "*management actions assumed for different scenarios should be internally consistent*". However, the CEA underlines that this needs to be done in a proportionate manner and should not result in a requirement for insurers to look at every individual scenario. A reasonable requirement would be for insurers to carry out sensible and representative spot checks. ⇨ The CEA suggests that the text is added: "*Internal consistency should be verified via a series of representative spot-checks. Proportionality should be applied in this regard."*
Para 3.21	See comments to Para 3.35
Para 3.24	**Emphasis should be on consistent principles for the allowance for management actions in Best Estimates** –The emphasis should be on having consistent principles for determining whether certain management actions are appropriate for a particular company to take them into account in their Best Estimate calculations, rather than trying to ensure consistency

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	between how insurers actually react in different circumstances. Management actions used by different companies in different situations can provide the key competitive differentiator between companies. ⇨ The CEA would request the following change to this paragraph: *“Further guidance should be developed at Level 3 in order to ensure that the management actions used for the Solvency II technical provisions calculations are appropriate for each insurer.”*
Para 3.25	**Companies should not be forced to allow for management actions** – See comments to Para 3.9. ⇨ The CEA suggests that “*should take account*” is changed to “*may take account*”. **The principle of proportionality needs to be taken into account in the allowance for management actions** – See comments to Para 3.12. ⇨ The CEA suggests that the sentence is added: “*The principle of proportionality should apply in the use of management actions in the estimation of future cash-flows.”* **Management actions should be considered in the context of governance and risk management** – The paper doesn’t sufficiently capture the links between the management actions assumed in the calculation of technical provisions and the issue of governance and risk management. A key consideration should be how the management actions are integrated in their risk management processes, i.e. how does the (re)insurer manage their risk and what does their risk management process assume would be the action taken under certain scenarios. ⇨ The CEA would request the addition of the text: *“.. and the extent to which these are considered under the risk management processes of the (re)insurer.”*
Para 3.27	**Objectivity needs to be balanced with flexibility, algorithms may not be required** - The CEA agrees that management actions should be objective, i.e. it should be clear what actions would be taken and when. Having quantitative trigger points and processes can be a good way of achieving this, especially when incorporating them into computer systems used to calculate the Best Estimate liability. Furthermore, we note that the phrase “algorithm” could lead to the expectation of a very

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	mathematical approach and as such would request that this was replaced with “processes” or “procedures”. However, the CEA does not agree that this will necessarily be the case. It may also be sensible to have some flexibility regarding the action as it is impossible to anticipate in advance exactly the conditions under which the action is taken. The CEA suggests that this criterion should require it to be clear what the management action is and when it would be taken, with it being noted that defining trigger points and processes in many cases helps achieve this. Lastly, we are concerned that the requirements around the “objectivity” criteria might be too constraining. It would be helpful to have examples in this respect. ⇨ The CEA would request that the text was adjusted as follows: “The first criterion implies that for the purpose of the calculation of the best estimate, the (re)insurance undertaking should define *what management actions will be taken and when each would be taken. In this regard,* having some clear trigger points and *procedures* showing when and how management actions might be applied by (re)insurance undertakings *will help achieve this*. All such triggers and *procedures* should have a clear rationale and should be suitably documented. The *management actions* will need to cover all scenarios which are relevant for the initial valuation and the recalculation of the best estimate.” ⇨ The CEA would request that examples are provided of how the “objectivity” criteria would work in practice.
Para 3.28	**Proportionality should apply in documentation and signing off, the board should agree general principles only for management actions** - The CEA agrees that management actions need to be documented and signed off, however, the extent of this should be subject to proportionality. This proportionate response must be in line with the governance structure. The CEA is concerned that the criteria expressed here could be too constraining and onerous as it is likely to be inappropriate and unrealistic to require the Board to review and sign-off management actions at a low level of granularity. In particular it is unlikely to be appropriate to require the Board to review mathematical algorithms. Furthermore, it would be helpful to have examples of what would and would not be acceptable. For example, a pragmatic and efficient approach might be for the Board to agree general principles for significant management actions with detailed implementation and sign-off being delegated to appropriate management. There should be a clear segregation of roles and responsibilities and processes in place, e.g.:

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	• Who does the calculation of any relevant triggers? • Who has to be informed if the triggers are activated? • Who has to decide on how to respond once the triggers are activated? ⇨ The CEA would request the following addition to this paragraph: *"Proportionality should apply in the requirements for documentation and sign-off of management actions. The Board should only be required to sign-off high level principles, with less senior management signing-off trigger points and algorithms."* ⇨ The CEA would request examples of what would be appropriate are included in this paragraph. **Inconsistencies in the paper** - We should also note that Para 3.28 requires the Board or delegated sub-committee to sign-off on each point whereas Para 3.14 requires the sign-off from the management. ⇨ The CEA requests that the requirement is clarified and is consistent throughout the paper.
Para 3.30	**The requirements for realism should be clarified** - The text requires that future management actions should be consistent with the insurance undertaking's current principles and practices. This requirement needs to be clarified as it should not be misinterpreted as a requirement for the management actions that apply to current benign conditions to also be expected to be those that apply in stress situations. Indeed a requirement for proof of evidence that the undertaking changes policy when a new situation occurs should not include a requirement for proof of evidence for a change in management actions in a stress situation when this change in management actions was already foreseen by the insurer's management. Furthermore, we should point out that any scenario approach or what if analysis deals with a hypothetical situation. Therefore the management actions based on the results are somehow hypothetical too. Therefore "realism" seems to be a quite strict criterion to deal with. We would propose that instead of using the criterion "realism" one should implement the principle: "*When calculating the technical provisions, insurers must ensure that assumptions on the use of management actions are reasonable."* Lastly, we should note that the requirement for realism will always require a significant degree of judgement and as such we would expect this requirement to be applied in a flexible manner.

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	⇨ The CEA would request examples of what would be appropriate are included in this paragraph.
Para 3.31	We agree with the statement that the undertaking can not undertake management actions which are contrary to their obligations to policyholders.
Para 3.32	**Competitiveness would be balanced against the need to protect against excessive losses**- The last part "*For a given scenario the assumed management actions should reflect an appropriate degree of competitiveness of the (re)insurance undertaking. The degree of competitiveness should be consistent with corporate planning.*" needs clarification. The key consideration is whether or not the management action would in practice be taken under the scenario being considered, e.g. would the need to maintain competitive bonus rates in order to write new business prevent in practice a cut in bonus rates or is it likely that solvency concerns would override such considerations? Indeed, avoiding excessive losses can often be a higher priority for undertakings than always being highly competitive. ⇨ The CEA would request that these sentences be re-worded to say: "For a given scenario the assumed management actions should reflect *the need of the (re)insurance undertaking to protect itself against unreasonable losses or to maintain a reasonable* degree of competitiveness. The *level of acceptable losses or the* degree of competitiveness should be consistent with corporate planning."
Para 3.33	**Proportionality should be applied here** - We believe that the demand to take account of the time to implement actions and the costs associated with these when calculating technical provisions could be somewhat unrealistic. The principle of proportionality should thus also be applied here.
Para 3.35	**Proportionality should apply to the principle of verifiability -** The CEA agrees with the principle of verifiability. However, the principle of proportionality should apply to the mechanisms required to verify the management actions. For example, with regards to the documentation requirements, these seem too detailed and burdensome for a (re)insurer (for example a requirement to trace the process, the ongoing work, the responsibilities and to verify the assumptions via a comprehensive plan, documentation and comparison of management actions in the current and in past valuations). **Objectivity needs to be balanced with flexibility, algorithms may not be required** - As described above in response to

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	Para 3.13 the CEA does not agree that there must necessarily be algorithms for the management actions. ⇨ The CEA would request the following addition to this paragraph: "*Proportionality should apply in the requirements for documentation and sign-off of management actions. The Board should only be required to sign-off high level principles, with less senior management signing-off trigger points and algorithms.*" **Management actions taken in previous years should not be binding but they will provide useful indicators** – Previous years' management actions are useful indicators but there may not be examples of previous management actions for all future possible scenarios, especially for the kind of management actions that might be appropriate under extreme conditions. It also may not be the case that the insurer would be expected to consider the same management actions again in the future. ⇨ The CEA would request the following addition to this paragraph: "*Bearing in mind that management actions taken in previous years will not necessarily provide relevant comparisons, particularly for the kind of management actions that might be appropriate under extremely adverse conditions.*" **Quantification of management actions may be overly onerous** - The CEA has concerns regarding the requirement for: "*assumptions should be verifiable through […] the quantification of the effect of management actions either individually or in aggregate*". The requirement for documentation linked to the quantification of the effect of management actions might be a very time-consuming and hard-to-implement constraint for (re)insurance undertakings. Therefore whilst we acknowledge that some quantification may be appropriate, this needs to be proportionate. Please also see comments to Para 3.36. ⇨ The CEA requests the principle of proportionality is applied in this area.
Para 3.36	**More information is requested on the degree of justification required** - We agree with the requirement to provide stronger justification for more extreme management actions. ⇨ The CEA would request examples of the degree of detail given in the differing strengths of the justification of management actions in Level 3.

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	⇨ For clarification purposes, we would request the last sentence is reworded as follows: "For example, stronger justification may be required for more extreme management actions *taken in normal circumstances or those management actions expected under extreme circumstances*."