

Insurance Europe key positions on long-term business ahead of the EGBPI meeting on 24 February.

Key messages to convey

Extrapolation of risk-free rates

- **The EC's proposals for changing the extrapolation methodology need a significantly different calibration than the one proposed by EIOPA** to avoid increasing the cost of providing long-term and guaranteed products to policyholders and increasing volatility.
- **The key "speed of convergence" parameter must be significantly increased to least 15% for the EURO and to around 70% for SEK** to avoid excessive increases in the valuation of long-term liabilities and magnification of the artificial volatility to interest rate movements.
- **The main extrapolation parameters including the convergence parameter, should be included in the Directive.**
- **Unjustified changes to the risk-free rate curves should not be introduced**, as they would increase the cost of long-term products and increase volatility.

Volatility adjustment (VA)

- **The EC has proposed several important and necessary changes** to the design and calibration of the VA:
 - Increasing the general application ratio (GAR) to 85%
 - Using an undiluted European reference portfolio
 - The Macro-VA component
 - Inclusion of an overshooting ratio adjustment (CSSR).
- **Credit spread sensitivity ratio (CSSR)**
 - The ratio should be designed to work for all markets. For countries whose currency is pegged to the Euro, **the CSSR should be calculated jointly for the Euro and the currencies pegged to the Euro.**
 - The calculation of the CSSR **should be done an annual basis** except where there is significant changes to the insurers' investment portfolio. This is necessary to reduce the operational burden associated with implementing a CSSR.
- **Risk correction**
 - Insurance Europe strongly **supports the retention of the current risk correction methodology.**
 - **If EIOPA's flawed approach is taken forward by policymakers, its calibration must be improved** to avoid increasing procyclicality and to avoid undermining the purpose and effectiveness of the Volatility Adjustment mechanism. This can be achieved by:
 - **Gradually reducing the impact of the risk correction on the level of the VA when credit spreads widen significantly** ie. when spreads are in excess of twice their long-term averages (LTAS).
 - **Reducing the percentages in case the spread values exceed their LTAS.**
 - **Insurance Europe analysis shows the following calibrations to be effective in reducing the increased procyclicality.**

Government bonds issued by member states

$$RC = 30\% * \min(S^+, LTAS^+) + 15\% * \max[0, \min(S^+ - LTAS^+, LTAS^+)] + 7.5\% * \max(0, S^+ - 2 * LTAS^+)$$

Other bonds, loans and securitisations

$$RC = 50\% * \min(S^+, LTAS^+) + 25\% * \max[0, \min(S^+ - LTAS^+, LTAS^+)] + 12.5\% * \max(0, S^+ - 2 * LTAS^+)$$

Other topics

- **Matching adjustment:** The EC proposal to remove the limitations on diversification of matching adjustment portfolios is welcome.
- **Risk margin:** The EC's proposals to introduce a lambda parameter and reduce the cost of capital are welcome and needed because they help reduce the unnecessarily high costs of long-term liabilities and reduce volatility.
- **Interest Rate risk:** The EC proposal to use the agreed Solvency II extrapolation approach to determine the illiquid part of the shocked interest rate curve is necessary and welcome. However, a change is needed to EIOPA's proposed methodology/calibration to avoid excessive impacts on the liquid part of the curve in very low interest rate environments.

Long-Term Equity Criteria

- **Insurance Europe welcomes the EC's stated intention to revise the eligibility criteria for the long-term assets class.** However, the detail of any changes will be key to achieve the improvements needed so that a significant portion of standard formula insurer's equity holdings would qualify.
- **The key aspects** which need to be addressed are:
 - Removal of quasi ring-fencing requirements
 - Extension of the application to OECD equities
 - Extension of application to all investment funds
 - Providing the appropriate options for insurers to demonstrate that they have the ability to avoid being forced to sell their long-term equity holdings – this should include the options put forward by EIOPA as well as a liquidity test approach.
- See annex for industry views on the Commission's questions relating to the LTE criteria.

Annex: Industry views on EC questions in “Focus on Long-term equity investments” document

Question 1: The industry supports **Option 1**, which is to follow EIOPA’s proposal. Therefore, the following part of the sentence should be deleted: “as well as the holding period of each equity investment within the subset”.

Question 2: The industry supports **Option 4**. The amendments supported by the industry are:
The sub-set of equity investment is included within a portfolio of assets which is assigned to cover the best estimate, its risk margin and share of the own funds of a portfolio of insurance or reinsurance obligations corresponding to one or several clearly identified businesses.

Question 3: The industry supports **Option 2**, ie follow EIOPA’s proposal but also delete the requirement of separate management of the assets.

Question 4: The industry supports **Option 1** ie follow EIOPA’s proposal.

Question 5: The industry supports **Option 2**, ie amend the criterion but in a different way than EIOPA’s proposal. Criterion 1e) should be amended as follows:

A policy for long-term investment management is set up for each long-term equity portfolio and reflects undertaking’s strategic asset allocation to hold the global exposure to equity in the sub-set of equity investment for a period that exceeds 5 years on average. The AMSB of the undertaking has signed off this strategic allocation in the investment management policies and these policies are frequently reviewed against the actual management of the portfolios.

Question 6: The industry supports **Option 2**, ie to extend the geographical location and include OECD equities.

Question 7: The industry supports **Option 4**:

- Stick to “illiquidity approach” but reduce average duration requirement to 6 years

And

- Explore possibility of developing a liquidity test

Question 8: The industry supports EIOPA’s proposal.

Question 9: The industry supports **Option 1**, ie to follow EIOPA’s proposal.

Question 10: The industry supports **Option 3** and the criterion should be amended as follows:

Where equities are held within collective investment undertakings or within alternative investment funds or within investments in related undertakings, the conditions set out in paragraph 1 of this Article may be assessed at the level of the funds and not of the underlying assets held within those funds

Question 11: The industry supports **Option 2 and Option 3** to allow supervisory discretion to waive or reduce penalties and reduce prohibition period to 12 months.

Question 12: The industry **does not support** the addition of this criterion.