

To: Solvency II Working Group
From: Prudential Team
cc:
Date: 9 January 2018
Reference: ECO-SLV-18-002

Subject: Summary of EIOPA 2017 LTG Report

Comment

As previously communicated with members (see [ECO-SLV-18-001](#)), EIOPA issued its 2017 Report on long-term guarantee measures and measures on equity risk (LTG Report) on 21 December 2017 (see [link](#)).

This is the second LTG report and has a similar structure to the 2016 report. However, due to the increased availability of data arising from the submission of QRTs, the scope of the report is extended to cover all undertakings.

It includes detailed, EEA-wide and jurisdictional, analysis of the impact of the LTG measures as well as the results of scenario testing of the parameters within the extrapolation of the risk-free rates. It further provides an analysis of the impact of the symmetric adjustment to equity risk, the implications of the use of the dynamic VA and how default risk is measured within the LTG measures.

The secretariat provides a summary of its main observations below and of the main quantitative results in the annex.

Background

EIOPA are mandated to provide an annual report on the impact of the application of the LTG measures and measures on equity risk to the EP, Council and Commission.

It is based upon data collected from the QRTs as at 31 December 2016 and an additional data request (see [FLASH-17-017](#)) which sourced data on the parameters used in the extrapolation of the RFR, the impact of the symmetric adjustment to equity risk and bond defaults in MA portfolios.

The secretariat's main observations on the content of the report include:

- At least one measure is applied by 783 undertakings covering 74% of the total EEA technical provisions.
- There continues to be stable or decreasing availability of LTG products across the EEA. EIOPA notes that it believes this trend is not related to the design of the LTG measures but rather due to the low-interest rate environment, the increased cost of guarantees and taxation regulation.
- Feedback from NSAs noted:
 - no concrete observations of any impact on policyholder protection from the use of LTG measures;
 - no specific cases where the LTG measures provided undue capital relief;
 - no clear significant link between the LTG measures and changes in behaviour of undertakings as long-term investors.
- The different supervisory approaches to the treatment of the VA (ie dynamic VA) within internal models is referenced in the context of competition and level-playing field. EIOPA's analysis of the internal models of

7 groups shows that, for this sample, the use of the dynamic VA reduces the SCR for credit risk by c.50% compared to the use of a static VA.

- Likewise, the different supervisory approaches to the application of the transition on technical provisions (TTP) is discussed in the context of competition and level-playing field.
- In the context of financial stability, the executive summary from the ESRB's report, *Regulatory risk-free yield curve properties and macroprudential consequences* (see [ECO-17-059](#)), is included. The ESRB work is noted to inform EIOPA's future work on the methodology of the risk-free curve and the Solvency II reviews. The ESRB's recommended impact assessments are of a similar nature to the scenario testing of the extrapolation of the risk-free yield rates conducted by EIOPA.
- EIOPA has provided analysis of the measurement of default risk within the LTG measures, both in the VA (risk correction) and MA (fundamental spread). Both measures are based upon long-term statistics/averages and, therefore, in the current low-spread market environment, they are provisioning for a relatively high cost of default.
 - For the VA, the risk corrections are noted to constitute a large part of the current spread (around 60%).
 - For the MA portfolios analysed, no losses from default have been reported however, there were some losses from downgrades. The magnitude of those losses was reported to be up to 0.02% of the portfolio value which was compared to the assumed fundamental spread on these portfolios of between 0.4%-0.7%.
- The thematic focus is on the public disclosure of the impact of the LTG measures (see [ECO-SLV-17-169](#)).
 - NSAs are noted to be broadly happy with disclosures of the LTG measures in the SFCRs.
 - Selected stakeholders (auditors, journalists, analysts, actuaries etc.) were invited to provide feedback on the public disclosure and are noted to be generally satisfied with the disclosure of the LTG measures in first year of SFCRs. However, they have also provided some area where they believe additional disclosure is warranted including information on duration mismatches, liquidity policies and scenarios analysis of different UFR values.
 - The IRSG highlighted that any disclosure should consider the audience's comprehension of information prior to its disclosure.

Annex – Quantitative summary of impact of LTG measures and measures on equity risk

	Number of firms applying measure/ in sample	EEA market share of undertakings using measure/ in sample	EEA SCR with measure	EEA SCR without measure	EEA SCR with measure	EEA SCR without measure	Impact on EEA capital requirement
			Undertakings applying measure		All undertakings		
LTG measures							
Matching adjustment	38	15.0%	162%	71%	229%	211%	€ 34 bn
Volatility adjustment	730	65.7%	223%	199%	229%	216%	€ 30 bn
Transition on RFRs	6	0.3%	186%	123%	229%	229%	€0 bn
Transition on TPs	163	24.8%	212%	124%	229%	212%	€9 bn
All measures	783	74%	217%	148%	229%	184%	€ 73 bn
Scenario analysis of RFR extrapolation parameters (†)							
1. Euro LLP moved to 30yrs	569	57%	242%	216%	-	-	€ 16 bn
2. Convergence point moved to 90 yrs*	569	57%	242%	237%	-	-	€ 3 bn
3 UFR decreased by 1%	569	57%	242%	230%	-	-	€ 7 bn

† Extrapolation analysis and results are based upon a sample of undertakings determined using a materiality threshold (see page 36 of report for more details)

*Convergence moved to 50 years for Swedish krona

Duration-based equity risk sub-module

- Used by one undertaking with negligible impact at EEA level.

Symmetric adjustment to equity risk

- Used by all undertakings who use the standard formula to calculate the equity risk charge
- EIOPA have analysed the impact of the removal of the symmetric adjustment to equity risk, based on information of a sample of undertakings covering 25% of total equity investments in the EEA
 - For undertakings in sample not applying the equity transitional, the SCR ratio decreases by 2% on average (218% to 216%)
 - For undertakings in sample applying the equity transitional, the SCR ratio decreases by 1% on average (303% to 302%).