

Summary of Comments on CEIOPS-CP-40/09

CEIOPS-SEC-103-09

Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate

CEIOPS would like to thank AFA, AMICE, Association of British Insurers, Association of Danish Mortgage Banks (Realkreditr , ASSOCIATION OF FRIENDLY SOCIETIES (AFS), AVOE – Aktuarvereinigung  sterreichs – Actuarial , BARRIE & HIBBERT, Bupa, CEA,

ECO-SLV-09-434, CRO Forum, Danish Insurance Association, Deloitte Touche Tohmatsu, DIMA (Dublin International Insurance & Management , Dutch Actuarial Society – Actuariel Genootschap (, European Insurance CFO Forum, Federation of European Accountants (FEE), FFSA, German Insurance Association – Gesamtverband der D, GROUPAMA, Groupe Consultatif , Hellenic Association of Insurance Companies, Institut des actuaires (France), International Underwriting Association of London, Investment & Life Assurance Group (ILAG), Ireland\39s Solvency 2 Group, excluding representa, Just Retirement Limited, KPMG ELLP, Legal & General Group, Lloyd\39s, Lucida plc, Munich RE, OAC plc, Pacific Life Re, PEARL GROUP LIMITED, PricewaterhouseCoopers LLP , Prof. Antoon Pelsser, Maastricht University, RBS Insurance, ROAM – Draft V2, The Association of Corporate Treasurers, The Equitable Life Assurance Society (UK), UNESPA (Association of Spanish Insurers), Uniqa, and XL Capital Ltd

The numbering of the paragraphs refers to Consultation Paper No. 40 (CEIOPS-CP-40/09)

No.	Name	Reference	Comment	Resolution
1.	AMICE	General Comment	These are AMICE 's view 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 The comments outlined below constitute AMICE 's primary areas of concern: 1. AMICE members are in favour of using the Swap Rate Curve (CEIOPS' option 1) as reference for the risk free rate curve. Indeed, contrary to the ECB AAA-rated government curve, the swap curve: - can be directly obtained from the market at all times whereas the ECB government curve is the result of a questionable methodology and it is not available at all times. - has an economic sense, due to its day-to-day use on the market.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			Obtaining implied volatilities for the swap curve is not a difficult task, whereas it is impossible to have them on an ECB curve, as it is not used for market transactions. Furthermore, we would like to emphasize the need to use upwards adjustments under certain market conditions: - Market values of corporate bonds include an illiquidity premium which is being managed following pillar II requirements. This illiquidity premium is not material for insurers when a Buy&Hold strategy is followed. An upward adjustment of the illiquidity spread on the risk free rate is a good way to correct it. - Due to the financial crisis, the market value of some non AAA-rated government bonds went down. This fall would not have had any impact on the undertaking's future results if a Buy&Hold strategy were followed (with the exception of a country going bankrupt). On the contrary, using market consistent approaches and risk free rates without adjustments would lead to a material fall of eligible elements, even if the country does not go bankrupt. If this problem is not solved by using an upward adjustment, insurers would have to avoid non AAA-rated government bonds in order to minimise the volatility of their solvency statement. This could have macro-economic impacts on the ability of non AAA-rated Government to raise debt.	
2.	Association of British Insurers	General Comment	We agree that the risk-free rate should be set using a series of principles, however we strongly disagree with CEIOPS's conclusion that only AAA-rated Government Bonds can fulfil these criteria. If applied this would contradict the principles of Solvency II and the Single Market and would have highly damaging consequences for Europe's economy and financial stability.	Noted.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
		We fundamentally disagree with the majority view at paragraph 3.30 which dismisses the liquidity premium without any proper consideration of the issue. The liquidity premium has a very substantial impact, particularly in distressed markets, on the valuation of illiquid liabilities, such as annuities. To reject this would be entirely counter to the requirement in Article 76(2) to set best estimate equal to the probability weighted average of future cashflows, using the relevant risk free interest rate term structure. This proposal would introduce a substantial layer of additional prudence, without justification and would be very damaging to the interests of millions of consumers in the UK and in other EU countries. We urgently call upon CEIOPS to reverse this decision. We agree that further work is needed to agree a harmonised application of the liquidity premium and would propose that a working group is established including representatives of CEIOPS, the industry and other experts to agree an appropriate approach. CEIOPS's proposals would oblige insurers increasingly to back their liabilities with AAA-rated government bonds otherwise an ALM mismatch would be introduced. However, only some EU governments are currently AAA-rated. In the Eurozone a significant proportion of the AAA-rated government bonds are supplied by the German and French governments. The effects of applying this policy may include: • Insurers will be likely to sell domestic government bonds in non 'AAA-rated countries' (e.g. Italy, Spain, Greece, Poland, Ireland, etc). This will make it harder for these governments to borrow and will increase the price they must pay to issue debt. • Insurers will be likely to reduce investment in industry, by reducing holdings of corporate bonds since they will be penalised	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		with excessive volatility against AAA government bonds if they hold them to back their insurance liabilities. This will reduce supply, and increase the cost, of capital to industry. • France and Germany will see government bond prices artificially inflated. This will push down yield curves beyond their proper equilibrium and result in an inappropriate reduction in discount rates, forcing companies to increase technical provisions across the board beyond an economic level, building in excessive prudence, and so increasing the price of insurance. • The use of only AAA-rated government bonds will introduce a pro-cyclical effect. If a government is downgraded from AAA-rated to AA-rated then this will impact the yield curve but it will also prompt insurers to rapidly move out of investment in this government's bonds. These are highly damaging consequences which arise from a mistaken interpretation that only AAA-rated government bonds can provide a risk-free discount rate. This ignores the reality that insurers need to invest in a wide range of high quality instruments (in part because there is an insufficient supply of government bonds of appropriate duration). It is perfectly possible to arrive at a yield adjusted to remove any reward for credit risk without requiring insurers to invest only in AAA-rated government bonds. Trying to force insurers to use only AAA-rated government bonds would introduce significant distortions and would apply a form of "tax" on the holding of any other asset, whether high quality corporate bonds or even government bonds in the insurer's own country. This "tax" would be over and above any adjustment for credit risk and would in part reflect the increased volatility introduced by the CP40 requirement to match all liabilities in essence to only two euro-countries whose government bonds are	

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			AAA-rated. A mis-match would be unavoidable, as the total amount of insurance liabilities would exceed the supply of these bonds available to insurers.	
3.	Association of Danish Mortgage Banks (Realkreditrådet)	General Comment	We have identified some issues which we would like to draw your attention to as they have serious consequences for the functioning of the Danish mortgage covered bond market. In CP 47, the issue relates to advice 4.163 – concentration risk on mortgage covered bonds (page 33) and in CP 40 to the discount rate curve. It is highly recommendable that the rules and regulations governing concentration risk and the discount rate curve be phrased in such a way that they support financial stability and ensure that it is possible to maintain systems to finance real property with a high degree of reliability of supply. This has been clearly demonstrated by the current financial crisis. We would like to point out that the Danish mortgage banks have weathered the financial storm better than other credit institutions in Europe. The Danish mortgage covered bond market has functioned with a high degree of stability, and loans have been granted on a current basis in proportion to the current demand. This has taken place without government guarantees backing Danish covered bonds. The explanation is to be found in the statutory regulation¹, which offers a high degree of protection to investors in covered bonds, and in the practice of the Danish mortgage banks. As regards the proposal in CP No. 40, we are very concerned about the suggestion in 3.54 about the benchmark for credit risk-free rates. A certain degree of flexibility in the choice of term structure with regard to liability measurement is very important to promote financial stability. It should be possible that the applied term structure to a certain degree mirrors the asset composition of a risk	Noted.

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
			averse insurance companies. In Denmark this implies a term structure which also includes covered bond instruments. 1 For a further description of the Danish mortgage credit model, cf. appendix 1.
4.	ASSOCIATION OF FRIENDLY SOCIETIES (AFS)	General Comment	The Association of Friendly Societies represents the friendly society sector in the UK. We have 46 friendly society members, who are all member-owned mutual organisations. Typically they offer long term savings and protection policies, with generally low minimum premiums. Friendly societies are typically small, though well-capitalised, and have a distinctly different business model to shareholder-owned insurers. We would like to thank CEIOPS for the chance to comment on this paper. Our general comments on this CP are that: 1. Swaps are better suited than government bonds to the task set by CEIOPS; 2. A liquidity premium does exist and it would be perverse and disproportionate of CEIOPS to ignore the ability to take account of this premium for illiquid liabilities without research giving a solid concrete reason; 3. No method of extrapolation or interpolation can be guaranteed to apply at all times and in all currencies (including non EEA currencies) and that CEIOPS should allow firms to use any method and then explain the method. Judgement plays a key role here. 4. Rates will need to be available daily as not all firms have year ends that conform to the normal calendar quarter.
5.			Confidential comment deleted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
6.	AVOE – Aktuarvereinigung Österreichs – Actuarial	General Comment	CEIOPS in this paper supports the usage of government bond rates as the basis for risk free rates. The current MCEV framework enforces swap rates. We would highly appreciate if the definitions of risk free rates could be harmonized between the two frameworks. Conducting similar calculations / valuations for two different frameworks (Solva II and MCEV) just because setting the interest rate curves differently not only will be an unnecessary burden for reporting insurers but also won't serve the idea of increasing transparency of information in the market. We suggest to consider as a suitable compromise taking (collateralized) swap rates (if available) and allowing for government rates in markets where these are not available.	Noted.
7.	BARRIE & HIBBERT	General Comment	B+H are happy to discuss the attached comments in person or on a call.	Noted.
8.	CEA, ECO-SLV- 09-434	General Comment	The CEA welcomes the opportunity to comment on the Consultation Paper (CP) No. 40 on TP – Risk free interest rate. 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. Ceioops proposes a series of principles for setting the risk free rate. This is broadly sensible, however Ceioops' conclusion that only AAA-rated Government Bonds can fulfil these criteria is in our view mistaken and if applied would contradict the principles of Solvency II and the Single Market and would have highly damaging	

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate		
		consequences for Europe's economy and financial stability. In our view, it is entirely possible to derive an appropriate risk-free term structure using swap markets. Ceiops' proposal would oblige insurers increasingly to back their liabilities with AAA-rated government bonds otherwise an ALM mismatch would be introduced. However, only some EU governments are currently AAA-rated. In the Eurozone a significant proportion of the AAA-rated government bonds are supplied by the German and French governments. The effects therefore of applying this policy may include: R Insurers will be likely to sell domestic government bonds in non 'AAA-rated countries' (e.g. Italy, Spain, Greece, Poland, Ireland, etc). This will make it harder for these governments to borrow and will increase the price they must pay to issue debt. R Insurers will be likely to reduce investment in industry, by reducing holdings of corporate bonds since they will be penalised with excessive volatility against AAA government bonds if they hold them to back their insurance liabilities. This will reduce supply, and increase the cost, of capital to industry. R France and Germany will see government bond prices artificially inflated. This will push down yield curves beyond their proper equilibrium and result in an inappropriate reduction in discount rates, forcing companies to increase technical provisions across the board beyond an economic level, building in excessive prudence, and so increasing the price of insurance. R The use of only AAA-rated government bonds will introduce a pro-cyclical effect. If a government is downgraded from AAA-rated to AA-rated then this will impact the yield curve but it will also prompt insurers to rapidly move out of investment in this government's bonds.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
		These are highly damaging consequences which arise from a mistaken interpretation that only AAA-rated government bonds can provide a risk-free discount rate. This ignores the reality that insurers need to invest in a wide range of high quality instruments (in part because there is an insufficient supply of government bonds of appropriate duration). It is perfectly possible to arrive at a yield adjusted to remove any reward for credit risk without requiring insurers to invest only in AAA-rated government bonds. Trying to force insurers to use only AAA-rated government bonds would introduce significant distortions and would apply a form of "tax" on the holding of any other asset, whether high quality corporate bonds or even government bonds in the insurer's own country. This "tax" would be over and above any adjustment for credit risk and would in part reflect the increased volatility introduced by the CP40 requirement to match all liabilities in essence to only two euro-countries whose government bonds are AAA-rated. A mis-match would be unavoidable, as the total amount of insurance liabilities would exceed the supply of these bonds available to insurers. We are concerned that CP40 currently provides different levels of guidance for Euro relative to non-Euro currencies. It is important that this is not the case in the final version of Level 2 which should provide the same level of detail under Level 2 for all currencies in order to ensure a level playing field is retained. The CEA believes that the "illiquidity premium" exists and should be taken into account for insurance liabilities and that its amount should be calibrated according to the degree of illiquidity of the term structure and the characteristics of the cash flows. It is important to recall that all insurance liabilities, due to their	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		very nature, are characterised to a varying degree by a certain level of illiquidity and predictability of future cash flows. This is due to a number of factors such as the portfolio's actuarial characteristics (e.g. longevity risk, lapse risk), contractual characteristics (e.g. surrender options) and policyholders' behaviour within its legal and fiscal environment. This, in principle, is the case both for life and non-life activities. This influences the investment choices of insurers. Insurers will invest in assets which match the nature of their liability obligations; this includes reflecting whether or not they are likely to have to make significant unexpected asset disposals in order to meet unexpected liability cash flows. Relatively liquid assets such as cash, swap-based instruments and government bonds are needed to match relatively less predictable liability cash flows e.g. where policyholders can cash-in their policy at relatively short-notice. Other things being equal, liquid assets are more highly valued than illiquid assets as many investors (i.e. not just insurers) need liquidity to match their liability outgoes. Expected returns on relatively illiquid assets therefore can be expected to be higher than those on otherwise equivalent liquid assets. This provides insurers, depending on the degree of predictability and stability of future liability cash flows, with the opportunity to realise the higher returns available on less liquid assets such as corporate bonds and so to achieve an "illiquidity premium". In other words, the nature of their liability cash flows is such that investing in less liquid cash flows does not expose them to the significant ALM and liquidity risks that would apply for less predictable liability cash flows, so they have significantly less need for liquid assets. As a consequence, the CEA believes that the "illiquidity premium" exists and should be taken into account for insurance liabilities and that its amount should be calibrated according to the degree of	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
			illiquidity of the term structure and the characteristics of the cash flows. This could be done by defining an appropriate function to be applied in a harmonised way to all insurance liabilities, undertakings and countries. As an example, we would expect that classes of business having a shorter duration (taking into account the characteristics of the class of business) would attract a very low illiquidity premium if any, whilst those classes of business having a longer duration would attract an enhanced illiquidity premium. This approach should ensure a level playing field across the EU and between insurance products. Ceiops states in CP40 that the majority of its members do not believe that the risk-free interest rate term structure should include an illiquidity premium. We strongly disagree with this statement and support the views of the minority of Ceiops members who believe that this area needs further investigation and, on the basis that a liquidity premium exists, a practical approach to its quantification and application. The ability to realise such “illiquidity premiums” is an important, well accepted and valued feature of insurance liabilities that have stable and predictable cash flows. It needs to be reflected in the transfer value approach used under Solvency II and as such the correct calibration of the risk-free discount rate will include this “illiquidity premium”. Further work is needed to develop its application. We believe that the Macroeconomic extrapolation technique is the most appropriate technique for extrapolation of market data at the long-end of the curve. However we should not preclude advances in this area in the future by setting out specific techniques at Level 2.
9.	CRO Forum	General	SUGGESTED KEY MESSAGES: Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
	Comment	40.A) Swap Rates should be the preferred risk-free rate (priority: very high) The CRO Forum strongly believes that swap rates have several desirable features that make them a suitable choice for the risk-free discount curve. These include; consistency with market pricing of derivatives and capital transactions, good liquidity and small degree of technical bias, a single swap term structure for the entire Euro area and collateralisation arrangements which provide protection in the event of default. By contrast the CRO Forum believes that Government Bonds suffer from several issues: • For example a completely risk free interest rate curve cannot be constructed by using Government bonds due to the presence of credit risk. Different degrees of credit risk between issuing countries cause distortions as seen by Government bond issuers with the same rating (AAA) traded at different spreads. The weighting of French and German bonds makes the proposed curve onerous for other Euro-zone countries. • There are liquidity and technical bias issues with many government bond markets (swaps are synthetic instruments and so less subject to the same supply and demand issues than gilt). Using government bonds as the reference rate is likely to introduce new technical bias for bonds of any issuer falling below an AAA rating. Finally government bonds will increase premiums rates relative to the true manufacturing costs ("risk free" hedging costs) of insurance. • For liabilities written in a currency / country unit whose government is not AAA rated, this will result in significant problems, deviating from economic reality. E.g. matching with government	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		bonds in Hungary (BBB) will result in interest rate mismatch, while this is not present in reality. When markets normalize, swap spreads will return to positive territory across the curve thereby creating an incentive for EU companies to reinsure business outside the EU jurisdiction or via securitization structures to the capital markets. This will jeopardize the principle of transparency which is one of the cornerstones that Solvency II is built upon. Finally, the CRO Forum supports the opinion of the European Commission stated in its letter to CEIOPS as at 26 March 2008 to use swap rates rather than government bond rates for QIS4. 40.B) A liquidity premium should be recognised for certain lines of business (priority: very high) The CRO Forum also support the use of transparent and consistently calculated liquidity premiums for certain highly illiquid insurance liabilities, as expressed in our letter issued on 12 June (Titled: "Solvency II implementing measures: Discounting illiquid insurance liabilities"). The swap curve plus liquidity premium should serve as risk free rate. The CRO Forum, in parallel with the CFO Forum, is currently working on this topic to provide concrete recommendations (not before October) on ways to measure Liquidity Premium and to apply it on the liabilities. We want to highlight that market consistent valuation is the most important valuation principle underlying the Directive; this should be kept in mind when deciding on an appropriate discount rate to be used in valuation of (re)insurance liabilities. 40.C) Extrapolation should be economically justifiable / simple (priority: high) The CRO Forum believes that in extrapolating yield curves it is	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			important to avoid spurious volatility and to have a method that can be feasibly used on a daily basis. Long term risk free data should be used where it exists to enable long term extrapolation. The CRO Forum recommends that the advice should not try to find one answer to fit all and (re)insurance undertakings should be allowed to choose a method most appropriate to the quality of available data.	
10.	Danish Insurance Association	General Comment	The approach adopted by CEIOPS puts way too much emphasis on just one of the criterions (credit risk) listed as desired characteristics for the term structure. The approach taken will enhance problems of procyclicality and could potentially threaten financial stability. In the Danish market we have for years applied a term structure based on the euro swap curve and that term structure represents a balanced mix of the characteristics which CEIOPS deem ideal. Our experience also shows the need for the authorities to be able to adjust the curve for non euro currencies in times of extreme market volatility. CEIOPS needs to allow for a pragmatic approach to the determination of the term structure. The Danish case represents a good example of how the desired characteristics can be obtained and combined in practice.	Noted.
11.	Deloitte Touche Tohmatsu	General Comment	European Union member firms of Deloitte Touche Tohmatsu are currently involved in the Level 2 Impact Assessment of Solvency II conducted by the European Commission. "Risk free interest rate" is one of the policy issues and options dealt with by this impact assessment. As a consequence, we have restricted our comments to those areas where there is no overlap with the issues addressed in the Impact Assessment.	Noted.
12.	DIMA (Dublin International Insurance &	General Comment	DIMA welcomes the opportunity to comment on this paper. The bulk of the commentary on this paper represents the views of DIMA's life reinsurance members.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	Management		Comments on this paper may not necessarily have been made in conjunction with other consultation papers issued by CEIOPS. We highlight the need for CEIOPS to have due regard to the majority view of industry and the minority view within CEIOPS to make an allowance for illiquidity premiums under certain circumstances. In the pricing of guarantees and options regard has to be given to existing market protocols for the evaluation of implied volatility as the output from a pricing model calibrated to market prices and the swap curve. In this regard where guarantees and options are to be priced with market implied volatility, it would appear to be consistent then to use the SWAP curve. The alternative of adjusting the implied volatility curve for the Swap spread would appear to be a disproportionate response and would at best only have presentational benefits and at worst could introduce additional complexity and risk to the management of these liabilities.	
13.	Dutch Actuarial Society – Actuariel Genootschap (	General Comment	We would like to congratulate CEIOPS with producing a very thorough analysis of the issue. We agree with most of the conclusions and recommendations. However, we would like to encourage CEIOPS to choose explicitly a principle based approach for the construction of the curve. The ECB-AAA curve is a reasonable choice in today's markets, but the decision of what the "best" curve is may change in the future. We believe a principle-based approach is more robust than a fixed choice for the ECB-AAA curve.	Noted.
14.	European Insurance CFO Forum	General Comment	The CFO Forum fundamentally disagrees with the proposal to use risk-free interest rates based on AAA government bonds. See comments in 3.54	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			The CFO Forum disagrees with the view that no allowance should be made for illiquidity premia. See comments in 3.30	
15.	Federation of European Accountants (FEE)	General Comment	The determination of discount rate for insurance liabilities is still to be discussed by the IASB. Currently, a debate is taking place on pension liabilities under IAS 19, but is not yet clear what will be the impact on the Insurance Project. We suggest reviewing this issue at a later stage, once the IASB has come to a position in these other areas.	Noted.
16.	FFSA	General Comment	FFSA considers that to avoid market distortions and ensure consistency CEIOPS should define the relevant risk-free term structure for all currencies at level 2 instead of postponing the non European currencies choice to level 3 as it is suggested in this CP. FFSA believes that risk free rate can be analyzed as the yield of AA corporate bonds minus the cost of credit risk of such bonds (as measured by their CDS). A good practical proxy could therefore be swap rate plus an illiquidity adjustment. FFSA notes that CEIOPS has not considered this latter adjustment, but disagrees with this approach as there seems to be a wide consensus amongst experts that illiquidity premia exist (as illustrated by the widening of spreads during the financial crisis). FFSA believes that the illiquidity adjustment shall be provided with the same method for all currencies and at the same level regardless of the liquidity of liabilities in order to ensure consistency among undertakings and avoid market distortions. The rationale for applying the same adjustment to all undertakings without distinction of liabilities liquidity can be found in the way best estimates and risk margin are calculated, taking already into account the volatility of underwriting risk such as lapses, mortality,	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		time value of options and guarantees, etc. In addition, SCR calculations also cover the risk of deviation of those parameters. Also, any manichean solution where certain contracts would be valued with an illiquidity premium and others without an illiquidity premium would lead to unjustified distortions between contracts which level of illiquidity is very close. Indeed, at portfolio level and on an economic basis, total illiquidity does not exist except for capitalization contracts that can not be surrendered. The uncertainty on future cash flows depends on the portfolio's actuarial characteristics (ex: Longevity risk), contractual characteristics (e.g. surrender option) and policyholders behavior (rational behavior of the policyholders). In addition, referring to the level of illiquidity embedded in liabilities would imply different liquidity premiums, hence different risk free rates which seems too complex and burdensome to implement (§3.30) in practice the use of SWAP rate is more appropriate to derive risk free rate than government bonds for the following reasons: R SWAP rates are provided with implied volatilities which are used to measure time value of options and guarantees and this component (time value) has to be followed by the insurer in order to protect policyholders and insurance solvency as a whole. R The swap market is deeper and more liquid than the Government bonds market R Since swaps are synthetic instruments they are less subject to the same supply and demand issues than Government bonds. R Help to ensure consistency between countries and also different frameworks (MCEV, Solvency II)	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			Comments required on 3.59: (extrapolation beyond the last available point of sufficient liquidity): FFSA believes that the simple extrapolation technique using the final liquid point on the forward curves is an appropriate and simple approach.	
17.	German Insurance Association – Gesamtverb and der D	General Comment	GDV appreciates CEIOPS' effort regarding the implementing measures and likes to comment on this consultation paper. In general, GDV supports the detailed comment of CEA. It should be noted that our comments might change as our work develops. Our views may evolve depending, in particular, on other elements of the framework which are not yet fixed – e.g. specific issues that will be discussed not until the third wave is disclosed. Overall comment: The most important issue regarding the risk free interest rate is to find an adequate extrapolation technique for the long end of the interest rate term structure where no reliable market data are available. For this purpose, the macroeconomic extrapolation technique is most sensible and should be applied. Furthermore, the use of Swap rates seems to be more sensible than the use of government bonds to determine a risk free term structure. CEIOPS proposes a series of principles for setting the risk free rate. This is broadly sensible, however CEIOPS' conclusion that only 'AAA-rated' Government Bonds can fulfil these criteria is in our view mistaken and if applied would contradict the principles of Solvency II and the Single Market and would have highly damaging consequences for Europe's economy and financial stability. CEIOPS' proposal would oblige insurers increasingly to back their liabilities with 'AAA-rated' government bonds otherwise an ALM mismatch would be introduced. However, only a minority of EU governments' are currently 'AAA-rated'. In the Euro zone this is	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		essentially Germany and France only. The effects therefore of applying this CEIOPS policy may include: R Insurers will be likely to sell domestic government bonds in non 'AAA-rated countries' (e.g. Italy, Spain, Greece, Poland, Ireland, etc). This will make it harder for these governments to borrow and will increase the price they must pay to issue debt. R Insurers will be likely to reduce investment in industry, by reducing holdings of corporate bonds since they will be penalised with excessive volatility against 'AAA' government bonds if they hold them to back their insurance liabilities. This will reduce supply, and increase the cost, of capital to industry. R France and Germany will see government bond prices artificially inflated. This will push down yield curves beyond their proper equilibrium and result in an inappropriate reduction in discount rates, forcing companies to increase technical provisions across the board beyond an economic level, building in excessive prudence, and so increasing the price of insurance. R The use of only AAA-rated government bonds will introduce a pro-cyclical effect. If a government is downgraded from AAA-rated to AA-rated then this will impact the yield curve but it will also prompt insurers to rapidly move out of investment in this government's bonds. These are highly damaging consequences which arise from a mistaken interpretation that only AAA-rated government bonds can provide a risk-free discount rate. This ignores the reality that insurers need to invest in a wide range of high quality instruments (in part because there is an insufficient supply of government bonds of appropriate duration). It is perfectly possible to arrive at a yield adjusted to remove any reward for credit risk without requiring insurers to invest only in AAA-rated government bonds.	

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
			Trying to force insurers to use only 'AAA-rated' government bonds would introduce significant distortions and would apply a form of "tax" on the holding of any other asset, whether high quality corporate bonds or even government bonds in the insurer's own country. This "tax" would be over and above any adjustment for credit risk and would in part reflect the increased volatility introduced by the CP40 requirement to match all liabilities in essence to only two euro-countries whose government bonds are 'AAA-rated'. A miss-match would be unavoidable, as the total amount of insurance liabilities would exceed the supply of these bonds available to insurers.
18.	GROUPAMA	General Comment	Groupama is in favour of using the Swap Rate Curve (CEIOPS' option 1) as the reference for the risk free rate curve. Indeed, contrary to the ECB AAA-rated government curve, the swap curve: (3.58) - is read directly from the market at all times. The ECB government curve is the result of a questionable methodology, and prevents participants from being able to get this major input directly from the market for solvency calculations - has an economic sense because of the day-to-day use of this reference on the market. - It is easy to obtain implied volatilities for the swap curve, whereas it is impossible to have implied volatilities on the ECB curve, as it is not used for market transactions. Furthermore, we would like to emphasize the need to use upwards adjustment in certain market conditions (3.30): - As the Directive states, the risk free rate should be free for default risk, but not for liquidity risk. At the end of 2008, market values of corporate bonds included an illiquidity premium, a risk

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			that is managed on pillar II and is usually not material for insurers following a Buy & Hold strategy. An upward adjustment of the illiquidity spread on the risk free rate appeared to be a good way of correcting it. - Due to the financial crisis, the market value of some non AAA-rated government bonds went down. This decline would not have any impact on future results of the company following a Buy & Hold strategy unless the government went bankrupt. However, using a market-consistent approach and a risk free rate without an adjustment would lead to a substantial decline in eligible elements, even if the Government did not go bankrupt. If this issue is not taken into account using an upward adjustment, insurers could avoid non AAA-rated government bonds in order to minimise the volatility of their solvency statement. This could have macro-economic impacts on non AAA-rated Government ability to raise debt.	
19.	Groupe Consultatif	General Comment	This is a key element of the Solvency 2 framework. Groupe Consultatif advocates deriving the risk free rate term structure for relatively liquid liabilities from a mix of relevant market information and profoundly disagrees on grounds of stability with the CEIOPS preference for a rate based on AAA government bonds only. Groupe Consultatif believes the liquidity characteristics of liabilities are directly relevant to their treatment in the Solvency 2 framework. Investors with illiquid liabilities earn as premium most of the element of yield which otherwise would be required to compensate for uncertainty of liability timing and are also unaffected by much of the variation in yield spreads on risky assets over and above variation in expected losses. These characteristics should be recognised in both risk-free discount rates and spread risk capital requirements in respect of such liabilities. Groupe Consultatif will be happy to co-operate in developing robust	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			practical algorithms which appropriately recognise liquidity characteristics We recognise the need for further work on extrapolation which we suggest should concentrate on the macroeconomic method broadly as outlined in Annex B.	
20.	Hellenic Association of Insurance Companies	General Comment	After reviewing the Consultation Paper No.40 concerning Technical Provisions and specifically the Risk free interest rate term structure, we would like to express our deepest concerns about the possible disturbance that will arise in the Greek Insurance market if the Implementing Measures mentioned in Consultation Paper 40. will be eventually applied as described. The Greek market shares the opinion that the sole use of the Government Bond Yield Curve of the European Central Bank (ECB AAA Government Bond Yield Curve) as a benchmark for a risk free EUR-rate, and the subsequent market-wide adoption of this discount rate by all insurance companies will in practice lead to distortions in the European Financial Markets (government debt supply and demand), forced AL mismatches in insurers' balance sheets and procyclicalities in times of crisis. The usage of appropriate swap rates (adjusted for credit risks) appears to be more compatible with the overall market and fair value approach that the Solvency II framework is built upon. We would propose further thorough investigation of the issue, given its potential negative impacts on the Greek and furthermore, the European (insurance) Market. More specifically for the Greek Insurance Market, concerning the extensive usage of public debt by local Insurance companies, these may be forced to shift their investments from Greek Government Bonds to other 'AAA' rated bonds (if available). Such a massive sale of Greek Government Bonds will technically bias the Bonds	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			unfavourably, will increase future public debt expenditure, if not limit the government's future financing ability. We are at your disposal for any queries or additional information. Sincerely The Hellenic Association of Insurance Companies Solvency II Committee	
21.	Institut des actuaires (France)	General Comment	Institut des actuaries, the third European actuarial association, advises that the risk free interests rates are established by a special task force (European commission, GCAE, CEIOPS, supervisors, industry, actuarial associations). This task-force will have to determine principles and rules in a coherent and homogeneous manner for all currencies.	Noted.
22.	International Underwriting Association of London	General Comment	We oppose the restriction the risk-free term structure to AAA-rated government bonds. In order to match their assets and liabilities, insurers would be put under pressure to back their liabilities with AAA-rated government bonds. We would urge CEIOPS to seriously consider the potential macroeconomic implications of this. It could reduce demand, (and therefore increase the cost to issue debt) for non-AAA rated issuers, and increase the cost to industry to obtain AAA-rated bonds (due to the increased demand, and the relatively few AAA-rated governments). Consequently, we believe that the risk-free swap rates should be the preferred basis for determining the risk free interest rate curve. Given the relatively fewer number of AAA-rated issuers, we would question whether there would be sufficient supply of bonds to meet demand - insurers will therefore need to have access to a wide variety of high-quality securities. We would also question whether liquidity of AAA-rated securities could be affected, as a consequence of significant levels of demand.	Noted.
23.	Investment	General	1. Swaps are better suited than government bonds to the task	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	& Life Assurance Group (ILAG)	Comment	set by CEIOPS; 2. A liquidity premium does exist and it would be perverse and disproportionate of CEIOPS to ignore the ability to take account of this premium for illiquid liabilities without research giving a solid concrete reason; 3. No method of extrapolation or interpolation can be guaranteed to apply at all times and in all currencies (including non EEA currencies) and that CEIOPS should allow firms to use any method and then explain the method. Judgement plays a key role here. 4. Rates will need to be available daily as not all firms have year ends that conform to the normal calendar quarter.	
24.	Just Retirement Limited	General Comment	We support much of the logic in this CP, but disagree fundamentally in two key areas: (1) We do not believe that AAA rated government bond should automatically be considered the "benchmark" for credit risk free rates, with other sources being used only where there are specific problems associated with the government bond yield curve. We broadly support the argument in Appendix C, that the adjusted swap curve should be the basis for valuing GBP liabilities, although we are concerned that no guidance is provided on the derivation of the credit risk adjustment. (2) The de-recognition of the illiquidity premium, where we believe there are compelling theoretical and practical arguments for its continued use. Observable market data, as well as historical evidence, show that financial and insurance markets demand additional compensation (an "illiquidity premium") for holding potentially illiquid assets. Insurers with illiquid liabilities do not require this compensation, and have been confident enough, for a	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			number of years, to enhance policyholder benefits as a result. This provides powerful evidence that such a premium exists. Disregarding this evidence would be contrary to Article 75 paragraph 3, which states that "The calculation of technical provisions shall make use of and be consistent with information provided by the financial markets". De-recognition of the illiquidity premium in markets where it is currently permitted would cause a material step increase in liabilities, estimated at €50bn for the UK market at 31 December 2008. An impact assessment based on our own circumstances supports this view. Proper consideration must therefore be given to retention of the illiquidity premium, given the significant impact its removal would have on investment strategies, pricing bases and product design. There are also likely to be public/social policy consequences, via the impact on the retirement income markets of a number of Member States. A key issue not addressed by the paper is the potential impact on financial markets of the proposed approaches to deriving the risk-free term structure, as illustrated by Appendix A. These impacts could easily feed back to undertakings' balance sheets in a vicious cycle.	
25.	KPMG ELLP	General Comment	We understand the importance of this issue within the Solvency II framework and are aware there are particular regions and firms in Europe who have reservations regarding the approaches suggested by CEIOPS. Firstly, there is a concern regarding the choice between AAA government bonds and swaps as a suitable starting point for risk free rates.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			Secondly, the discount rate applied needs to take the specific features of the insurance liabilities valued using this discount rate into account. In most cases the policyholder can expect a very high level of security and thus the discount rates should be equivalent to instruments which ensure such a high level of security, such as highly rated government bonds or swaps. When liabilities are illiquid, the discount rate applied should take this feature into account. Finally, further work is also needed on extrapolation. We have heard concerns raised about different EEA market using different instruments to value the risk-free rate. Our view is that consistency of the reference rate across Europe would be advantageous. In our view the system of swaps rates which are traded in almost all (if not all) EEA countries offer the most consistent framework for a reference rate across the EEA and globally.	
26.	Legal & General Group	General Comment	We strongly disagree with two of the main recommendations included in this advice. - For liquid liabilities, we do not agree that government bond rates should be used to the exclusion of swap rates. We consider that neither is entirely risk free and that swap rates have significant advantages. - For illiquid liabilities, we consider that the risk free rate should include allowance for the liquidity premium.	Noted.
27.	Lloyd's	General Comment	We are generally supportive of this consultation paper's proposals. We have no objections to the proposed technical basis for calculating the risk free interest rate. However, there are a number of practical issues which we believe that the paper does not	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			address. In particular, we strongly argue that the principal of proportionality should apply where a small section of the liabilities are denominated in a particular currency (especially for currencies outside the EEA). For these small blocks of business, an approximate risk free interest rate curve should be permitted where the overall impact on total technical provisions is not significant. The paper is only concerned with the valuation of technical provisions. However, presumably the same approach should be applied where other items in the balance sheet are to be discounted.	
28.	Lucida plc	General Comment	Lucida is a specialist UK insurance company focused on annuity and longevity risk business. We currently insure annuitants in the UK and the Republic of Ireland (the latter through reinsurance). It is clear that for annuity business, the approach set out in this paper would lead to technical provisions in excess of those envisaged by Article 75.2, i.e. that the resulting technical provisions would exceed the "current amount insurance undertakings would have to pay if they were to transfer their obligations to another insurance undertaking". One way of correcting this discrepancy, would be for allowance to be made for illiquidity of annuity liabilities when determining the discount rate.	Noted.
29.	Munich RE	General Comment	We fully support all of the GDV statements and would like to add the following points: 1. It should be stressed in the CP that the risk free interest rate should not depend on : R Own credit risk of a (re)insurance undertaking, i.e. via consideration of CDS spreads R Actual asset allocation of the undertaking.	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			2. All in all we advocate to use swap rates as risk free interest rates. 3. Extrapolation should be economically justifiable / simple to avoid spurious volatility and to have a method that can be feasibly used on a daily basis.	
30.	PEARL GROUP LIMITED	General Comment	We have a concern that this CP like all the other CPs takes a prudent view. While this might feel appropriate in each CP we are worried that this will mean that the overall Solvency II legislation will be overly prudent when summed over all the CPs. We are surprised, and concerned, that CEIOPS intends not to allow the illiquidity premium when CEIOPS recognises the benefit of liquidity within assets but will not recognise the benefit of having illiquid liabilities. We disagree with CEIOPS on this.	Noted.
31.	PricewaterhouseCoopers LLP	General Comment	We have two comments of significant note on this Consultation Paper. The comments relate to the exclusion of an illiquidity premium in determining the discount rate and the definition of the Eurozone risk free rate as the European Central Bank "AAA" rated term structure. Please refer to paragraphs 3.30 and 3.34.	Noted.
32.	Prof. Antoon Pelsser, Maastricht University	General Comment	I would like to congratulate CEIOPS with producing a very thorough analysis of the issue. I agree with most of the conclusions and recommendations. However, I would like to encourage CEIOPS to choose explicitly a principle based approach for the construction of the curve. The ECB-AAA curve is a reasonable choice in today's markets, but the decision of what the "best" curve is may change in the future. I believe a principle-based approach is more robust than a hard-coded choice for the ECB-AAA curve.	Noted.
33.	RBS Insurance	General Comment	We agree with the philosophy of this paper that it is sensible for all companies to use a consistent risk free interest rate derived using a uniform methodology where appropriate.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			However this does need to be balanced with the idiosyncracies of the various markets and it is strange that the impact assessment was performed for the Euro currency alone (appendix D.40). We believe due to the importance of the longer term yields assumed for the UK annuity market, and the technical bias in UK sterling government bond, that a full impact assessment should be performed for the UK market. We believe there should be more information about the adjustment made to the risk-free rate should a government security get downgraded from 'AAA' We also have some questions on the use of the risk free interest rate in relation to Economic Scenario Generators within the Internal Capital Model.	
34.			Confidential comment deleted.	
35.	ROAM – Draft V2	General Comment	CEIOPS advises that for the calculation of the best estimate "For each valuation date, the relevant risk-free interest rate term structure should be determined on the basis of market data relevant for the valuation date. » We disagree with this point. We consider that the relevant risk interest rate term structure should not depend on market data relevant for the valuation date. Indeed, this mark to market approach could not only lead to substantial changes in the value of liabilities due to their high volatility but also to procyclical effects. CEIOPS sets out in points 3.12 and 3.13 that the government bond yield curve as well as the swap rates curve could lead to technical biases due to an artificially high demand from financial institutions and pension funds for specific durations. We consider that this artificially high demand from financial	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		institutions and pension funds could also be raised by future Solvency II regulatory constraints if the relevant risk-free interest rate term structure is originated from market data relevant for the valuation date (mark to market approach). Indeed, as set out by The Norwegian Financial. Services Association: "[...] In a situation where an insurance company's available capital is approaching SCR1, the prudent manager will move to lower the risk in the portfolio. Risk could be lowered by buying fixed income assets with a duration that is relevant to the liabilities the company holds. Since the duration of pension liabilities tend to exceed 20 years, insurers demand will be for long duration instruments. These instruments are generally few and exposed to thin trading. Thus, the long-term end of the interest market is usually less liquid than the short end. The increased demand in long-term bonds will depress interest rates, creating a vicious circle when insurance companies have to reduce the risk even more as liabilities seem to increase in value, decreasing available capital." For these reasons we consider that the best estimate should not depend on a risk-free interest rate term structure obtained with market data relevant for the valuation date (mark to market approach). Further, IASB has recently taking initiatives to better respect economic valuation of assets in regard of stakeholders commitments structure and to reduce procyclical effects (ED/2009/7 Financial Instruments: Classification & Measurements). To do so, IASB decided that an entity using a 'buy and hold' investment policy - as a large part of long term insurance company - should value instruments producing predictable cash flows at their amortised cost rather than at their fair value.	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			Therefore, for consistency of valuation between assets and commitments and to reduce volatility and procyclical effects of the method proposed in this Consultation Paper, we encourage CEIOPS to take into account not only a similar approach for the valuation of assets but also for the estimation of the best estimate. To do this, we propose to value the best estimate at its amortised cost when the underlying commitments have no surrender option. For the calculation of the best estimate, the future cash flows estimated at the valuation date should be split up between their subscriptions contracts years and then be actualised separately with the free interest rate term structure relevant for each subscription year.	
36.	The Association of Corporate Treasurers	General Comment	The principal interest of the ACT in relation to the matter of this consultation arises from insurance companies and potentially other regulated persons investing in corporate obligations. The proposals as they stand will, we believe, reduce the willingness of insurance companies and other affected bodies to invest in corporate obligations which will in turn have a negative effect of the real economy and the ability of companies to finance themselves efficiently. We do not think that this impact should be accepted as we do not think the valuation basis is fully justified for the reasons set out below. We recognise that in looking at the return on a bond-like asset, the yield to maturity on acquisition above the real risk free rate available from AAA government bonds at that time can be seen as including varying premiums, conventionally R An inflation premium R A credit risk premium	Noted.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
		R A premium to reflect the lower liquidity of the asset R Possibly a premium related to the maturity of the asset (although this can be seen as part of the inflation premium) and R An error term. When comparing to a conventional government bond yield the two major items are the credit risk and liquidity premiums. We acknowledge that the credit risk premium can be seen the present value of the default risk on the asset. I.e. the expected return on the asset is to that extent diminished. Taking account of default risk, then, the expected return from the investment, above the government bond yield, is mostly composed of the liquidity premium. There has been much good work done on understanding liquidity premiums over the years both academically and by central banks, for example the Bank of England has many papers on the subject which are available on their website. The liquidity of corporate bonds is much lower than that of liquid government bonds because of the smaller total outstandings of a corporate bond – even the largest – and the “buy and hold” propensity of bond investors. However, such “buy and hold” investors will usually have long-term obligations and do not normally need liquidity at interim stages prior to maturity. This ability to reap the liquidity premium in most or part of their portfolios is, or should be, a key business characteristic of long-term insurers and pension funds. Accordingly, we believe that the discount rates used in valuing long-term obligations of such firms and funds should recognise this	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
			liquidity premium in respect of their long term obligations. Not to recognise this would open up a volatility in valuations between the long-term holders' assets and liabilities. We understand from conversations with representatives of such holders that this would materially reduce their ability/ willingness to hold investments other than AAA government bonds. As such holders are major buyers of long-term corporate obligations that is alarming. With the increased capital requirement of banks and the reduced size of bank balance sheets, non-financial corporates will be increasingly reliant on bond and equity markets for long-term funding over future years. To penalise regulated holders of such obligations would bear on real economy activity levels in an undesirable manner, raising the corporate cost of capital across the board. At a time of hoped-for recovery from the downturn, this would be doubly unfortunate. Accordingly we hope that in this fundamental issue, CEIOPS will be deeply thoughtful about the indirect consequences of the valuation methods proposed and recognise that liquidity premiums are a legitimate part of the expectations of investors and of the economy in general and should not be excluded in valuations.
37.	UNESPA (Association of Spanish Insurers)	General Comment	1. UNESPA (Association of Spanish Insurers and Reinsurers) appreciates the opportunity to analyze and comment on Consultation Paper 40 on TP – Risk free interest rate UNESPA is the representative body of more than 250 private insurers and reinsurers that stand for approximately the 96% of Spanish insurance market. Spanish Insurers and reinsurers generate premium income of more than € 55 bn, directly employ 60.000 people and invest more than € 400 bn in the economy.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		The comments expressed in this response represent the UNESPA's views at this stage of the project. As our develops, these views may evolve depending in particular, on other elements of the framework which are not yet fixed. CEIOPS proposes a series of principles for setting the risk free rate. This is broadly sensible, however CEIOPS's conclusion that only 'AAA-rated' Government Bonds can fulfil these criteria is in our view mistaken and if applied would contradict the principles of Solvency II and the Single Market and would have highly damaging consequences for Europe's economy and financial stability. CEIOPS's proposal would oblige insurers increasingly to back their liabilities with 'AAA-rated' government bonds otherwise an ALM mismatch would be introduced. However, only a minority of EU governments' are currently 'AAA-rated'. In the eurozone this is essentially Germany and France only. The effects therefore of applying this CEIOPS policy may include: R Insurers will be likely to sell domestic government bonds in non 'AAA-rated countries' (e.g. Italy, Spain, Greece, Poland, Ireland, etc). This will make it harder for these governments to borrow and will increase the price they must pay to issue debt. R Insurers will be likely to reduce investment in industry, by reducing holdings of corporate bonds since they will be penalised with excessive volatility against 'AAA' government bonds if they hold them to back their insurance liabilities. This will reduce supply, and increase the cost, of capital to industry. R France and Germany will see government bond prices artificially inflated. This will push down yield curves beyond their proper equilibrium and result in an inappropriate reduction in discount rates, forcing companies to increase technical provisions	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		across the board beyond an economic level, building in excessive prudence, and so increasing the price of insurance. R The use of only AAA-rated government bonds will introduce a pro-cyclical effect. If a government is downgraded from AAA-rated to AA-rated then this will impact the yield curve but it will also prompt insurers to rapidly move out of investment in this government's bonds. These are highly damaging consequences which arise from a mistaken interpretation that only AAA-rated government bonds can provide a risk-free discount rate. This ignores the reality that insurers need to invest in a wide range of high quality instruments (in part because there is an insufficient supply of government bonds of appropriate duration). It is perfectly possible to arrive at a yield adjusted to remove any reward for credit risk without requiring insurers to invest only in AAA-rated government bonds. Trying to force insurers to use only 'AAA-rated' government bonds would introduce significant distortions and would apply a form of "tax" on the holding of any other asset, whether high quality corporate bonds or even government bonds in the insurer's own country. This "tax" would be over and above any adjustment for credit risk and would in part reflect the increased volatility introduced by the CP40 requirement to match all liabilities in essence to only two euro-countries whose government bonds are 'AAA-rated'. A mis-match would be unavoidable, as the total amount of insurance liabilities would exceed the supply of these bonds available to insurers. Therefore, we understand that the swap curve fits the requirements suggested in this CP and that a correction for illiquidity on the liability is a stability element, which would encourage the insurance companies to the development of risk management procedures and	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		give a better protection to the customers. - Swap curve. As a starting point we would say that all the market curves present some credit risk, so the basic issue will be to determine what is the best approach to the "risk-free rate" curve. In our opinion, the market curve that approaches the best to the risk free rate concept is the swap curve (more detail in Section 3.7). The main reason for that is the swap curve is an unfunded curve, which does mean there is not exchange of notional. Therefore, the only risk in the operation is the present value of the difference between the interest rates bought and sold in the operation (fix and floating). On top of that, the swap counterparties use to have settlement programs which reduces even more the possible credit risk. Despite what we might think in a first approach, government curves present credit risk. In fact, if we go through the history we will see how some governments have suspended payments, that is defaulted, which in addition is reflected by the existence of a CDS market on governments bonds. An interesting point, and as a difference over the swap curve is that if a government defaults, the defaulted notional equals the nominal invested plus the difference between the current swap rate (fix) and the IRR (which mathematically equivalent to the previous swap rate differential). If it wants to be adapted our standards to market value, we should be accepting the standards that already exists in the market, that is, as mentioned above, the use of the swap curve in net present value calculations and, the existence of a market risk in governments. (Article 74.1 a) of the Directive). - Illiquidity premium (see comments in point 3.30). The reason for the inclusion of a liquidity premium in the liabilities valuations is obvious: it can be obtained a greater profit out the	

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
			funds coming from illiquid liabilities than from the funds coming from liquid liabilities. Having said so, the next question is to identify the liabilities that we can identify as eligible to include the illiquidity premium. In our opinion, the illiquidity premium should be extended to all the liabilities in which it does not exist a surrender value at all, to the liabilities in which the market risk of the invested assets in the case of surrender will not be suffered by the insurance company, or to policies with high penalties in case of anticipated surrender. Generally speaking we could say that market participants accept that illiquid bonds pay higher yields than liquid bonds. This extra yield has a value, which in our view is not contained in any form in the market risk calculation. Therefore we propose the inclusion of an illiquidity premium in the liabilities calculation in the form of a spread over the risk free rate curve. We understand the implementation of this illiquidity premium to the "risk-free rate" should be structured on principles (see point 3.30). Finally we would like to add that the not inclusion of a illiquidity premium on the liability valuation would be a clear disincentive for insurance companies in various markets, in which we could mention the Spanish one, than will probably finish in a lower protection to the policyholders as it will clearly limit the development of this key market.
38.	Uniqa	General Comment	Beside all detailed discussions how to determine the "risk-free" interest rate term structure, we argue strongly for a uniform and standardized proceeding in defining the interest rate term structure across different projects, valuation purposes (e.g. MCEV, IFRS4). Not only because of setting effort limits but also because a uniform approach would help to gain acceptance. The definition of any risk free interest rate term structure should Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
			incorporate the following two principles: 1. As riskless as possible from a default point of view 2. As liquid as possible, i.e. financial products which mirror the selected risk free interest rate must exist and should be traded in financial markets. Proper risk identification or mitigation processes must be defined for the part of the term structure which is needed for the valuation of the portfolio of the undertaking and does not fulfil one of the two principles stated above. We believe it is a crucial lesson learned from the current financial crisis to establish measures for the calculation of the interest rate term structure in times of illiquid and/or unreliable market environments. These measures or general rules must be defined beforehand in order to minimise national specificities and supervisory arbitrage in times of crisis.
39.	XL Capital Ltd	General Comment	CP 40 recommends that the risk free interest rate structure should normally be based on the yield on relevant government bonds, which is a change from QIS4 in which swap rates were used. We believe that a swaps-based risk-free term structure should be used. For the eurozone, CP40 specifies that the ECB AAA government bond yield curve will be used. This is likely to reduce demand for non AAA rated government debt at a time when those governments are likely to wish to issue additional debt. In paragraph 3.30 CEIOPS says that the great majority of its members believe that the risk-free interest rate term structure should not include an illiquidity premium reflecting certain cash-flow characteristics of insurance obligations. A minority of CEIOPS

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			members believe that this area needs further investigation. We would urge further investigation into this issue, as we fully support the stance taken by the ABI in its letter to the Chancellor of the Exchequer and believe that an illiquidity premium should be included. We believe there is sufficient evidence in the market to show the existence of a genuine premium for illiquid assets, and that the level of matching in most annuity portfolios means that this premium will emerge, and so should be taken into account in the discounting of liabilities.	
40.	CRO Forum	2.3.	Overall, paragraph 2.3 refers to article 75 of the FD that defines the objective for the valuation of (re)insurance obligations: a) Clause 2 refers to transaction prices. We believe this implies inclusion of some illiquidity premiums. b) Clause 3 refers to financial markets – again that would imply an illiquidity spread.	Not agreed. There seems to be no market where a reliable market price for (re)insurance obligation can be observed to draw this conclusion.
41.	ACA – ASSOCIATION DES COMPAGNIES D'ASSURANCES DU	3.	We agree with CEIOPS recommendations but we worry about the inconsistency between risk-free rates assumptions used for SII IFRS and MCEV calculation while it should be consistent. Will the CEIOPS be in discussion with the IAS Board and the CFO Forum about that?	
42.			Confidential comment deleted.	
43.	CRO Forum	3.	The choice of the risk-free interest rate should also be market consistent with regard to option prices. As market implied volatilities for both equity and interest rate options are quoted based on the swap curves, a market consistent valuation of options	Not agreed. Options are not valued on a risk-free basis.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			does not seem to be achievable when using government rates. Hence, when valuing embedded options and guarantees the swap curve should be used as the natural market-consistent choice for the risk-free interest rate. This is also in accordance with the use of swap rates in other actuarial reporting framework, e.g. the MCEV.	
44.	Dutch Actuarial Society – Actuariel Genootschap (	3.	We would urge CEIOPS to choose more explicitly for a principles based approach. Focus first on the principles as formulated in 3.3, and second the implementation of which curve to choose. The selection of the “best” curve may change over time due to changing markets and institutional settings.	Noted. The three stage approach allows for a change of the curve.
45.	Munich RE	3.	The choice of the risk-free interest rate should be market consistent with regard to option prices. As market implied volatilities for both equity and interest rate options are quoted based on the swap curves, a market consistent valuation of options does not seem to be achievable when using government rates. This is also in accordance with the use of swap rates in other actuarial reporting framework, e.g. the MCEV.	Not agreed. Options are not valued on a risk-free basis.
46.	Prof. Antoon Pelsser, Maastricht University	3.	I would urge CEIOPS to choose more explicitly for a principles based approach. Focus first on the principles as formulated in Section 3.3, and second the implementation of which curve to choose. The selection of the “best” curve may change over time due to changing markets and institutional settings.	Noted. The three stage approach allows for a change of the curve.
47.	Institut des actuaires (France)	3.1.	The notion of realism should be more specific . Should we understand the point mentioned in paragraph 3.8. as an absence of arbitrage opportunity?	Noted.
48.	ASSOCIATION OF FRIENDLY	3.2.	We would agree with the Commission that the swap rates are more suitable for Solvency 2. The rates are available for more durations and remove the need for	Noted.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	SOCIETIES (AFS)		interpolation and extrapolation. They are also less likely to be prone to technical issues.	Not agreed. The Euro swap rate market does not seem to be sufficiently liquid for long maturities.
49.	Investment & Life Assurance Group (ILAG)	3.2.	We would agree with the Commission that the swap rates are more suitable for Solvency 2. The rates are available for more durations and remove the need for interpolation and extrapolation. They are also less likely to be prone to technical issues.	Noted. Not agreed. The Euro swap rate market does not seem to be sufficiently liquid for long maturities.
50.	AMICE	3.3.	-	Noted.
51.	Association of British Insurers	3.3.	We believe that the risk-free rate should also satisfy the principle of being "market-based" Recital 27 (and implicitly Recital 28) of the Framework Directive requires the risk-free term structure to be based on, and make optimal use of, the information provided by the financial markets. The valuation techniques used to determine best estimate liabilities therefore need to be calibrated consistently with market prices. As described above, in order to replicate the prices of financial instruments, the risk-free term structure needs to be consistent with the discount rates used to value these financial instruments, which requires the use of swaps and not AAA-rated government bonds. An approach based exclusively upon AAA-rated government bonds will result in a valuation of technical provisions which is inconsistent with market prices and hence which will not meet the market-based principle of Solvency II.	Not agreed. Options are not valued on a risk-free basis.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
52.	CEA, ECO-SLV- 09-434	3.3.	We believe that the risk-free rate should also satisfy the principle of being "market-based". Recital 27 (and implicitly Recital 28) requires the risk-free term structure to be based on, and make optimal use of, the information provided by the financial markets. The valuation techniques used to determine best estimate liabilities therefore need to be calibrated consistently with market prices. As described above, in order to replicate the prices of financial instruments, the risk-free term structure needs to be consistent with the discount rates used to value these financial instruments, which requires the use of swaps and not AAA-rated government bonds. An approach based exclusively upon AAA-rated government bonds will result in a valuation of technical provisions which is inconsistent with market prices and hence which will not meet the market-based principle of Solvency II.	Not agreed. Options are not valued on a risk-free basis.
53.	CRO Forum	3.3.	We entirely agree that no own credit risk should be considered when determining the risk-free interest rate. Taking into account a (re)insurers own credit risk would give the wrong incentive: a less credit worthy undertaking would have a higher surplus as the market value of the liabilities would go down. However, even though the swap rate contains some elements of credit risk so do government bonds. As the curve does not depend on a (re)insurers own credit risk, the swap curve does not lead to wrong incentives. One could also think of the example that government bonds are subject to rating changes, i.e. they could attracting credit risk. This would make them ineligible according to a) in the definition.	Noted.
54.	Dutch Actuarial Society –	3.3.	We agree with the principles stated here. However, d) and e) are very closely related and could be combined under "High Liquidity for All Maturities". The principles f) and g) are, in our view, not	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	Actuarieel Genootschap (		principles related to the risk-free term-structure but to the supervisory implementation of such curves. As such, the principles f) and g) should be deleted from "3.1.1 Desired characteristics" and moved to the implementation-part 3.1.4. In fact, f) and g) are not even mentioned in the current text in 3.53.	
55.	German Insurance Association – Gesamtverband der D	3.3.	We believe that the risk-free rate should also satisfy the principle of being "market-based" Recital 27 (and implicitly Recital 28) requires the risk-free term structure to be based on, and make optimal use of, the information provided by the financial markets. The valuation techniques used to determine best estimate liabilities therefore need to be calibrated consistently with market prices. As described above, in order to replicate the prices of financial instruments, the risk-free term structure needs to be consistent with the discount rates used to value these financial instruments, which requires the use of swaps and not 'AAA-rated' government bonds. An approach based exclusively upon 'AAA-rated' government bonds will result in a valuation of technical provisions which is inconsistent with market prices and hence which will not meet the market-based principle of Solvency II.	Not agreed. Options are not valued on a risk-free basis.
56.	Groupe Consultatif	3.3.	There is no requirement in the Level 1 text to base the risk-free interest rate term structure on any particular instrument and the Groupe believes that indeed it is inappropriate to seek to do this. As has been strongly underlined by recent experience, markets are constantly in flux, with the spreads between bonds of various issuers, between bonds and swaps and between various forms of swaps subject to constant change. These changes can be because of varying real and/or perceived risks, changes in investor preferences (associated with movements in trading liquidity) and because of unknown technical influences. The risk-free rate term	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			structure is not directly observable but may reasonably be deduced from a range of market information at any given point of time. At any future point in time this deduction should be considered afresh having regard to market developments. Linking to a single class of instrument would be potentially destabilising. The mentioned criteria are reasonable from a theoretical point of view. In practice the requirements should be reduced to the most important criteria: negligible credit risk; realism; instead of reliability a process in the case of market crisis; high liquidity for relevant maturities; almost no technical biases. Furthermore the term structure should ensure consistency in the valuation of liabilities and replicating or matching assets.	
57.	Munich RE	3.3.	We entirely agree that no own credit risk should be considered when determining the risk-free interest rate. Taking into account a (re)insurers own credit risk would give the wrong incentive: a less credit worthy undertaking would have a higher surplus as the market value of the liabilities would go down. However, even though the swap rate contains some elements of credit risk it is seen as a proxy for a AA credit curve by the markets. As the curve does not depend on a (re)insurers own credit risk, the swap curve does not lead to wrong incentives.	Noted.
58.	Prof. Antoon Pelsser, Maastricht University	3.3.	I agree with the principles stated here. However, d) and e) are very closely related and could be combined under "High Liquidity for All Maturities". The principles f) and g) are, in my view, not principles related to the risk-free term-structure but to the supervisory implementation of such curves. As such, the principles f) and g) should be deleted from "3.1.1 Desired characteristics" and moved to the implementation-part 3.1.4. [In fact, f) and g) are not even mentioned in the current text in 3.53.]	Noted.
59.			Confidential comment deleted.	

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
60.	AMICE	3.4.	AMICE members agree with the CEA that the principle of "No credit risk" should be replaced by "No significant credit risk"	Not agreed. The Level 1 text requires the discount rates to be risk-free. Although there may be practical limitations to fully achieve this objective, it should not be disregarded.
61.	Association of British Insurers	3.4.	There is no such thing as an entirely risk-free instrument. Even today's AAA-rated government bonds may be subject to downgrade (e.g. Ireland) and ultimately are subject to some credit risk. Indeed, a number of European governments' bonds carry a higher risk premium than swaps. It is therefore inappropriate to strive to find an entirely "risk free" asset. Instead it is more appropriate to find a mechanism that can provide an appropriate supply of assets and a "relevant risk free interest rate", with the minimum degree of distortion to markets, where credit risk is negligible and any reward for credit risk is properly adjusted for. The key question therefore is whether the suggested credit risk inherent in swaps makes it inappropriate to use them as a basis for the risk-free term structure. We do not agree that the "no credit risk" criterion is necessarily the most important. All criteria are important but it makes no sense to rank them individually. For example, it would be highly inappropriate to use a term structure which entails no credit risk, but has no realism, no reliability and no liquidity. CEIOPS must leave room for identification of term structures which possess the various criterions to different degrees but which are sound and useful in a pragmatic approach to Solvency II.	Not agreed. The Level 1 text requires the discount rates to be risk-free.
62.	ASSOCIATIO	3.4.	We believe swaps have protections in place to remove credit risk.	Not agreed. Swaps are not free of

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	N OF FRIENDLY SOCIETIES (AFS)			credit risk.
63.			Confidential comment deleted.	
64.	CEA, ECO-SLV-09-434	3.4.	There is no such thing as an entirely risk-free instrument. Even today's AAA-rated government bonds may be subject to downgrade (e.g. Ireland) and ultimately be subject to some credit risk. Indeed, a number of European governments' bonds carry a higher risk premium than swaps. It is therefore inappropriate to strive to find an entirely "risk free" asset. Instead it is more appropriate to find a mechanism that can provide an appropriate supply of assets and a "relevant risk free interest rate", with the minimum degree of distortion to markets, where credit risk is negligible and any reward for credit risk is properly adjusted for. The key question therefore is whether the suggested credit risk inherent in swaps makes it inappropriate to use them as a basis for the risk-free term structure. R It is inappropriate to attempt to find a completely risk free instrument. R We disagree with Ceiops' statement that bonds issued by governments with AAA rating can be considered as completely risk free while swaps do involve credit risk. We do not agree that the "no credit risk" criterion is necessarily the most important. All criteria are important but it makes no sense to rank them individually. For example, it would be very inappropriate to use a term structure which entails no credit risk, but has no realism, no reliability and no liquidity. Ceiops must leave room for identification	Not agreed. The Level 1 text requires the discount rates to be risk-free.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			of term structures which possess the various criteria to different degrees but which are sound and useful in a pragmatic approach to Solvency II.	
65.	CRO Forum	3.4.	We cannot see that this follows directly from the level 1 text: In article 74,1 it is stated that no account of the own credit standing should be made (see comment to 3.3.). However, within this article only AAA-governments are considered to be a proxy for risk free. In the credit risk sections all EEA governments are considered risk free. We have the following comments: 1) We believe that no government is risk free and hence we do not agree with the statements in the credit risk sections. 2) We note that even for AAA rated govt bonds rates differ by country. 3) In any case the two statements are inconsistent. If government bond rates are used for the discount rates argued by their risk freeness, if at all this would only apply to AAA rated government bond rates and not for govt bonds rated lower. For government bond rates that are not AAA rated appropriate adjustments should apply. Furthermore, we believe that using only AAA government bonds will have a very significant adverse effect on financial stability as this may create massive demand for AAA government bonds at the expense of any country rated just below. Moreover should a rating agency downgrade a AAA country, a massive decrease in demand would follow with a vast increase in the impact of the economic downturn.	Not agreed. This follows from Article 76(2). Partly agreed. AAA rated government bonds are the ideal case. See revised text.
66.	Danish Insurance	3.4.	We do not agree that the "no credit risk" criterion is necessarily the most important criterion. All criteria are important but it makes	Not agreed. The Level 1 text requires the discount rates to be

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	Association		no sense to rank them individually. For example, it would be very inappropriate to use a term structure which entails no credit risk, but has no realism, no reliability and no liquidity. CEIOPS must leave room for identification of term structures which possess the various criterions to different degrees but which are sound and useful in a pragmatic approach to Solvency II.	risk-free.
67.	German Insurance Association – Gesamtverb and der D	3.4.	There is no such thing as an entirely risk-free instrument. Even today's 'AAA-rated' government bonds may be subject to downgrade (e.g. Ireland) and ultimately be subject to some credit risk. Indeed, a number of European governments' bonds carry a higher risk premium than swaps. It is therefore inappropriate to strive to find an entirely "risk free" asset. Instead it is more appropriate to find a mechanism that can provide an appropriate supply of assets and a "relevant risk free interest rate", with the minimum degree of distortion to markets, where credit risk is negligible and any reward for credit risk is properly adjusted for. The key question therefore is whether the suggested credit risk inherent in swaps makes it inappropriate to use them as a basis for the risk-free term structure. R It is inappropriate to attempt to find a completely risk free instrument. R We disagree with CEIOPS' statement that bonds issued by governments with AAA rating can be considered as completely risk free while swaps do involve credit risk. We do not agree that the "no credit risk" criterion is necessarily the most important. All criteria are important but it makes no sense to rank them individually. For example, it would be very inappropriate to use a	Not agreed. The Level 1 text requires the discount rates to be risk-free.

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
			term structure which entails no credit risk, but has no realism, no reliability and no liquidity. CEIOPS must leave room for identification of term structures which possess the various criterions to different degrees but which are sound and useful in a pragmatic approach to Solvency II.
68.	Groupe Consultatif	3.4.	We do not believe that it is appropriate to draw a distinction between government issuers based on evaluations by a third party which are subject to change. What would be the implications if one country were downgraded from AAA or another upgraded to that level? It is true that swap-based rates (depending on the term of the floating leg) would traditionally have been thought of as embracing a modest element of bank credit risk. However government and bank credit have become to some degree commingled recently and we note that long swap-based rates fell below corresponding government bond rates recently. Bonds issued by governments with an AAA rating should in theory have no material credit risk, However, as was seen with the Irish Republic government bonds, in the market turmoil their spread widened relative to other Euro denominated government AAA rating bonds in anticipation of the credit rating downgrade. Therefore just because a government bond has an AAA rating it does not mean there is no relevant credit risk. Indeed from a practicality position if we look over a period of 50 years plus, which equates to very long term liabilities then no government bond can be regarded as risk free. The risk is greater as time increases which is another factor to consider when looking at durations over, say, 10 years In today's capital markets risk free instruments do not exist. Even AAA-rated government bonds may be subject to downgrades or credit events like prolongation or restructuring. Hence the interest rate term structure should be determined with respect to negligible credit risk and minimal market distortions.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
69.	Investment & Life Assurance Group (ILAG)	3.4.	We believe swaps have protections in place to remove credit risk.	Not agreed. Swaps are not free of credit risk.
70.	Legal & General Group	3.4.	Bonds issued by governments with an AAA rating should in theory have no material credit risk. However, as was seen with the Irish Republic government bonds, in the market turmoil their spread widened relative to other Euro denominated government AAA rating bonds in anticipation of the credit rating downgrade. Therefore, just because a government bond has an AAA rating it does not mean there is no relevant credit risk. Indeed from a practicality position if we look over a period of 50 years plus, which equates to very long term liabilities then no government bond can be regarded as risk free. The risk is greater as time increases which is another factor to consider when looking at durations over, say, 10 years.	Not agreed. Irish government bonds are not rated AAA.
71.	Munich RE	3.4.	We cannot see that this follows directly from the level 1 text: In article 74,1 it is stated that no account of the own credit standing should be made (see comment to 3.3.).	Not agreed. This follows from Article 76(2).
72.	XL Capital Ltd	3.4.	"Bonds issued by governments with AAA ratings can be considered to have no relevant credit risk, while it is accepted that other instruments, for example swaps, do involve relevant credit risk" Since it is possible to remove any reward for credit risk, we believe a swaps-based risk free structure would better meet the core principles of Solvency II, without forcing insurers to invest in AAA-rated government bonds.	Not agreed. The choice of government bond rate as discount rates does not force the undertakings to hold government bonds.
73.	Groupe Consultatif	3.5.	We believe the quantification of credit spreads fundamentally depends on the nature of the assets and liabilities. As an example consider the position for 2 policyholders buying respectively an	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			annuity with and without surrender value options. The nature of the liabilities here needs to reflect the fact that the policyholder with no surrender rights would expect the assets to have higher yield than the one with surrender options as the risks are different. Therefore a market consistent approach should reflect this in either the liabilities or the assets.	
74.	Legal & General Group	3.5.	We believe the quantification of credit spreads fundamentally depends on the nature of the assets and liabilities. As an example, consider the position for two policyholders buying an annuity, one with and one without surrender value options. The value of the liabilities associated with the annuity that does not have a surrender option should be lower than the policy that has surrender options. In the UK this has been achieved by adjusting the discount rate applied to the liabilities to allow for the additional yield that can be earned by holding less liquid assets to meet the liabilities, after allowing for credit risk.	Noted.
75.	OAC plc	3.5.	We believe the quantification of credit spreads fundamentally depends on the nature of the assets and liabilities. As an example consider the position for 2 policyholders buying respectively an annuity with and without surrender value options. The nature of the liabilities here needs to reflect the fact that the policyholder with no surrender rights would expect the assets to have higher yield than the one with surrender options as the risks are different. Therefore a market consistent approach should reflect this in either the liabilities or the assets. In the UK this has been achieved through the assets and is often called a liquidity premium. As the investors in assets with different liabilities are subject to different risks and therefore the quantification of the yield relative to, say swaps or government bonds, between credit risk, uncertainty and illiquidity will depend on the basis risk between the assets and liabilities.	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
76.	ACA – ASSOCIATION DES COMPAGNIES D'ASSURANCES DU	3.6.	Inside the euro zone, the spread between rates on bonds issued by different governments can be significant as recent experience showed. Only the lowest rates should be considered as risk free rates. This is not the case for the yield curve derived by the ECB since bonds issued by governments considered more risky by the market are taken into account in its construction.	Not agreed. The ECB curve is based on AAA rated government bonds.
77.	CRO Forum	3.6.	The argument that “For currencies linked to only one government, however, the government bond rate can still carry credit risk”, whereas for a currency like the EUR where several AAA-rated governments exist no credit risk is contained, is not consistent. If a single government bond can have credit risk then so can a grouping of bonds from different governments. Also, government debt can be downgraded from AAA regardless of the number of governments making up a currency area.	Not agreed. The statement does not say that all single government bond rates carry credit risk.
78.			Confidential comment deleted.	
79.	Groupe Consultatif	3.6.	We are not sure whether the reference to ‘credit risk’ here is intended to mean only ‘spread risk’, but in any event we believe we do not agree. Different euro zone AAA-rated government bonds trade at different yields and therefore a euro curve derived by the European Central Bank will still carry credit risk averaged across those AAA-rated governments and therefore the position is entirely the same as for a currency linked to only one government.	Noted.
80.	Institut des actuaires (France)	3.6.	Should this paragraph mention the fact that credit risk is linked to an issuer and not to a currency?	Not agreed. CEIOPS holds the view that for each currency only one risk-free interest rate term structure should be specified.
81.	International Underwriting	3.6.	Question: Paragraph 3.6 notes that “the Euro zone has several AAA-rated governments, and a risk-free government bond curve	Yes, it could be a problem if the issuer of the bonds had a

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	Association of London		can be based on the Euro curve derived by the ECB. For currencies only linked to one government, however, the government bond rate can still carry credit risk." Would this still be a problem if, for example, the government bonds were denominated in Pound Sterling, and the insurer's liabilities in question were also held in Pounds Sterling?	significant probability of default.
82.	Just Retirement Limited	3.6.	The statement in the final sentence, that the "government bond rate" for "currencies linked to only one government" carries credit risk is odd, since it implies that government bonds in currencies linked to multiple governments are credit risk-free, which is spurious. The degree of credit risk underlying a specific government bond is independent of the currency in which it is issued, and is based on other factors – otherwise there would not be the observed differences in bond yields across the eurozone Also Treaty obligations explicitly prevent payment of one government's liabilities by another, therefore the credit risk of individual governments within the eurozone should be independent of the fact that they belong to a single currency.	The final sentence refers to a single non AAA rated government. Not agreed. CEIOPS holds the view that for each currency only one risk-free interest rate term structure should be specified. Noted.
83.	Legal & General Group	3.6.	Different euro zone AAA-rated government bonds trade at different yields and therefore euro curve derived by the European Central Bank will still carry credit risk averaged across those AAA-rated governments. Therefore, the position is entirely the same as for currencies linked to only one government.	Not agreed. The single government could be non-AAA rated.
84.	OAC plc	3.6.	Different euro zone AAA-rated government bonds trade a different yields and therefore euro curve derived by the European Central Bank will still carry credit risk averaged across those AAA-rated governments and therefore the position is entirely the same as for a currencies linked to only one government.	Not agreed. The single government could be non-AAA rated.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
85.	RBS Insurance	3.6.	There is still potential for credit risk whether a bond is related to one, or more than one, government. The start of this paragraph suggests that “having several AAA-rated governments” implies risk-free, whereas later in the paragraph the suggestion is that a bond from a single government “can still carry credit risk”. We believe a consistent definition is required, particularly since not all euro zone governments are AAA-rated.	Not agreed. The single government could be non-AAA rated.
86.	UNESPA (Association of Spanish Insurers)	3.6.	The AAA rating today would only apply the bonds of German and French governments	Not agreed. There are other members of the euro zone with a AAA rating, for example the Netherlands and Luxembourg.
87.	Association of British Insurers	3.7.	We disagree with CEIOPS’ arguments as in practice the collateralisation arrangements on Lehman Brothers Inc. swaps worked well and provided companies with good protection. While there were isolated problems over the type of assets used as collateral on certain transactions, it should be noted that this is not a standard feature of swap contracts. Furthermore, it is safe to assume that the risks associated with not having appropriate restrictions on what assets can be posted as collateral will have been learned. We should also point out that as well as the fact that some banks has been bailed out during the financial crisis, also some governments had to be bailed out by either loans issued by the IMF or the European Commission. CEIOPS’ criticism of swaps - that collateral does not protect against Disagreed. The single government could be non-AAA rated.replacing cover in the event of default - is inappropriate -	Not agreed. We assume that a significant part of the payments were made by institutes bailed out by a government, recapitalised by a government or profiting from a government guarantee. Not agreed. No governments were bailed out, in particular no AAA rated governments.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
			whether or not a company decides to buy a particular asset doesn't affect the risks associated with that asset. The current crisis has also showed high default vulnerability for "AAA-rated" governments. Some European governments were bailed out by loans issued by the EC or the IMF. Therefore this argument should not be used in dismissing the swap as not being risk free. Thus the statement that AAA rated government bonds are have no credit risk is not a valid assumption.
88.	CEA, ECO-SLV- 09-434	3.7.	We disagree with Ceiops' arguments as in practice the collateralisation arrangements on Lehman Brothers Inc. swaps worked well and provided companies with good protection. While there were isolated problems over the type of assets used as collateral on certain transactions, it should be noted that this is not a standard feature of swap contracts. Furthermore, it is safe to assume that the risks associated with not having appropriate restrictions on what assets can be posted as collateral will have been learned. We should also point out that as well as the fact that some banks has been bailed out during the financial crisis, also some governments had to be bailed out by either loans issued by the IMF or the European Commission. Ceiops' criticism of swaps - that collateral does not protect against replacing cover in the event of default - is inappropriate - whether or not a company decides to buy a particular asset doesn't affect the risks associated with that asset. The current crisis has also showed high default vulnerability for "AAA-rated" governments. Some European governments were bailed out by loans issued by the EC or the IMF. Therefore this Not agreed. We assume that a significant part of the payments were made by institutes bailed out by a government, recapitalised by a government or profiting from a government guarantee. Not agreed. No governments were bailed out, in particular no AAA rated governments.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			argument should not be used in dismissing the swap as not being risk free. Thus the statement that AAA rated government bonds are have no credit risk is not a valid assumption.	
89.	CRO Forum	3.7.	It is correct that investment banks showed higher default vulnerability due to the Lehman Brothers insolvency. However, the resulting conclusion that there is a significant credit risk connected to swap is too strong and not supported by evidence. Collateral agreements are an effective way of reducing the credit risk. In general collateral is of high quality and has therefore limited exposure to default. Moreover, collateral agreements are dynamic and changes in the market value result quickly in collateral calls. Lastly, it is hard to explain that long-dated swap have significant credit risk given the fact that long-dated swap rates currently trade below AAA government rates. We believe that there is no argument that govt bonds are a better proxy for risk free rates than swap rates from a credit risk perspective.	Noted.
90.	Danish Insurance Association	3.7.	The credit risk on swaps is usually not of a material scale. And the swap market possesses many of the other important criterions for determining an appropriate term structure. Hence, the swap market entails a sound mix of warranted features for the term structure. The reference to the Lehman Brothers insolvency could also be turned around: Lehman Brothers became insolvent and many banks, including European ones, were bailed out by governments. However, the European insurance industry weathered the crisis rather well with little government involvement. That illustrates the need to not over focus on one of the features which a sound term structure ought to reflect. If swaps are replaced by government bonds, it can be expected	Not agreed. Please note that most European insurers currently use discount rates even more safe than government bond rates to discount technical provisions.

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09	
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			that life insurance companies will to some extent use the repo market to fund the hedging and by doing that, they will be exposed to the same kind of counterpart risk that exist today with swaps. The collateral will only cover the current value of the repo trade. If interest rates change they may have a significant uncovered exposure.	
91.	German Insurance Association – Gesamtverb and der D	3.7.	We disagree with CEIOPS’ arguments as in practice the collateralisation arrangements on Lehman Brothers Inc. swaps worked well and provided companies with good protection. While there were isolated problems over the type of assets used as collateral on certain transactions, it should be noted that this is not a standard feature of swap contracts. Furthermore, it is safe to assume that the risks associated with not having appropriate restrictions on what assets can be posted as collateral will have been learned. It is also perhaps fair to say that these were exceptional conditions which may not be repeated in the next fifty or one-hundred years. We should also point out that as well as the fact that some banks has been bailed out during the financial crisis, also some governments had to be bailed out by either loans issued by the IMF or the European Commission. CEIOPS’ criticism of swaps - that collateral does not protect against replacing cover in the event of default - is inappropriate - whether or not a company decides to buy a particular asset doesn’t affect the risks associated with that asset. The current crisis has also showed high default vulnerability for “AAA-rated” governments. Some European governments were bailed out by loans issued by the EC or the IMF. Therefore this argument should not be used in dismissing the swap as not being risk free.	Not agreed. We assume that a significant part of the payments were made by institutes bailed out by a government, recapitalised by a government or profiting from a government guarantee. Not agreed. No governments were bailed out, in particular no AAA rated governments.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			Thus the statement that AAA rated government bonds are have no credit risk is not a valid assumption.	
92.	Groupe Consultatif	3.7.	Swaps mainly have investment banks as one of the counterparties; however, unlike bonds it is misleading to refer to them as issuers as swaps are not issued. The investment bank may either take the long or short position depending on what position the other counterparty wants. The investment banks play an important role in reducing any credit risk involved with swaps. The investment bank would generally aim not to take a net risk on swap contracts; instead they would have offsetting swaps with other counterparties. Investment banks vary the collateralisation requirements depending on the credit standing of the counterparty and thus help the functioning of the market. Credit risk only exists where an investment bank defaulting coincides with a market movement affecting the swap or the swap position that has not be fully collateralised. As the collateralisation generally takes place daily the exposure is related to the daily movement We agree that term interbank rates defining the floating legs of most swaps may reflect an element of interbank credit risk with a consequential impact on the rate on the fixed leg (particularly at short durations). Overnight indexed swap-based rates most avoid such distortion.	Noted.
93.	Legal & General Group	3.7.	Swaps mainly have investment banks as one of the counterparties; however, unlike bonds it is misleading to refer to them as issuers as swaps are not issued. The investment bank may either take the long or short position depending on the position the other counterparty wants.	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			The investment banks play an important role in reducing the credit risk involved with swaps. The investment bank would generally aim not to take a net risk on swap contracts; instead they would have offsetting swaps with other counterparties. Investment banks vary the collateralisation requirements depending on the credit standing of the counterparty and thus help the functioning of the market. Credit risk only exists where an investment bank defaulting coincides with a market movement affecting the swap or where the swap position has not been fully collateralised. As the collateralisation generally takes place daily the exposure is related to the daily movement.	
94.	Munich RE	3.7.	It is correct that investment banks showed higher default vulnerability due to the Lehman Brothers insolvency. However, the resulting conclusion that there is a significant credit risk connected to swap is too strong and not supported by evidence. Collateral agreements are an effective way of reducing the credit risk. In general collateral is of high quality and has therefore limited exposure to default. Moreover, collateral agreements are dynamic and changes in the market value result quickly in collateral calls. Lastly, it is hard to explain that long-dated swap have significant credit risk given the fact that long-dated swap rates currently trade below AAA government rates.	Not agreed. We assume that a significant part of the payments were made by institutes bailed out by a government, recapitalised by a government or profiting from a government guarantee. Not agreed. No governments were bailed out, in particular no AAA rated governments.
95.	OAC plc	3.7.	Swaps mainly have investment banks as one of the counterparties; however, unlike bonds it is misleading to refer to them as issuers as swaps are not issued. The investment bank may either take the long or short position depending on what position the other counterparty wants. The investment banks play an important role in reducing any credit	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			risk involved with swaps. The investment bank would generally aim not to take a net risk on swap contracts; instead they would have offsetting swaps with other counterparties. Investment banks vary the collateralisation requirements depending on the credit standing of the counterparty and thus help the functioning of the market. Credit risk only exists where an investment bank defaulting coincides with a market movement affecting the swap or the swap position that has not be fully collateralised. As the collateralisation generally takes place daily the exposure is related to the daily movement	
96.	Association of British Insurers	3.8.	An AAA-rated government bond-based term structure does not meet the realism structure Both government bonds and swaps-based instruments exist in markets and so in that sense both are “real”. However, the supply of long-dated AAA-rated government bonds is much smaller than the amount needed to match all insurance liabilities. Accordingly, the CP 40 assumption that all liabilities could be matched by AAA-rated government bonds is flawed. This is particularly important as the implicit assumption under Solvency II is that policyholders in a failing company can be protected by de-risking the business, through orderly run-off and / or transfer to another insurance undertaking. This requires ready access to suitable risk-free assets in sufficient quantity to match technical provisions. Accordingly, the defined risk-free term structure effectively determines what assets may be used to provide a risk-free return and so this needs to be based on a “real” benchmark that reflects an active and available market. This will typically be in the swaps market, but may also be derived from other asset markets such as mortgage bonds or high quality	Not agreed.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			corporate bonds. An issue particular to the Eurozone is that Euro government bonds do not exist. Instead, each government within the Eurozone issues their own debt, which is subject to local market supply and demand issues and the market's view of the credit worthiness of the particular government. Thus, otherwise identical government bonds in the Eurozone will have different prices and yields. In CP40, CEIOPS proposes to use the Euro curve derived by the European Central Bank ("ECB"). However, this fails the Realism principle because insurance undertakings cannot purchase assets that provide this yield. By contrast there is a single Euro swap-based term structure within the Eurozone. Therefore an AAA-rated government bond-based term structure does not meet the realism structure, whereas swaps and other market-based alternatives would meet the realism principle.	
97.	CEA, ECO-SLV- 09-434	3.8.	An AAA-rated government bond-based term structure does not meet the realism structure. Both government bonds and swaps-based instruments exist in markets and so in that sense both are "real". However, the supply of long-dated AAA-rated government bonds is much smaller than the amount needed to match all insurance liabilities. Accordingly, the CP 40 assumption that all liabilities could be matched by AAA-rated government bonds is flawed. This is particularly important as the implicit assumption under Solvency II is that policyholders in a failing company can be protected by de-risking the business, through orderly run-off and / or transfer to another insurance undertaking. This requires ready access to suitable risk-free assets in sufficient quantity to match technical provisions. Accordingly, the defined risk-free term structure effectively determines what assets may be used to	Not agreed. The realism criterion requires that the rate can be earned in practice without taking on credit risk.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			provide a risk-free return and so this needs to be based on a “real” benchmark that reflects an active and available market. This will typically be in the swaps market, but may also be derived from other asset markets such as mortgage bonds or high quality corporate bonds. An issue particular to the Eurozone is that Euro government bonds do not exist. Instead, each government within the Eurozone issues their own debt, which is subject to local market supply and demand issues and the market’s view of the credit worthiness of the particular government. Thus, otherwise identical government bonds in the Eurozone will have different prices and yields. In CP40, Ceiops proposes to use the Euro curve derived by the European Central Bank (“ECB”). However, this fails the Realism principle because insurance undertakings cannot purchase assets that provide this yield. By contrast there is a single Euro swap-based term structure within the Eurozone. Therefore an AAA-rated government bond-based term structure does not meet the realism structure, whereas swaps and other market-based alternatives would meet the realism principle.	
98.	CRO Forum	3.8.	We fully support this view. Furthermore, we see that swap rates are possible for all (re)insurers to earn, as evidenced by the significant insurers in the market.	Noted. Not agreed. The swap rate can be earned, but not without taking on significant credit risk.
99.	German Insurance Association – Gesamtverband der D	3.8.	An ‘AAA-rated’ government bond-based term structure does not meet the realism structure Both government bonds and swaps-based instruments exist in markets and so in that sense both are “real”. However, the supply of long-dated ‘AAA-rated’ government bonds is much smaller than the amount needed to match all insurance liabilities. Accordingly,	Not agreed. The realism criterion requires that the rate can be earned in practice without taking on credit risk.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			the CP 40 assumption that all liabilities could be matched by 'AAA-rated' government bonds is flawed. This is particularly important as the implicit assumption under Solvency II is that policyholders in a failing company can be protected by de-risking the business, through orderly run-off and / or transfer to another insurance undertaking. This requires ready access to suitable risk-free assets in sufficient quantity to match technical provisions. Accordingly, the defined risk-free term structure effectively determines what assets may be used to provide a risk-free return and so this needs to be based on a "real" benchmark that reflects an active and available market. This will typically be in the swaps market, but may also be derived from other asset markets such as mortgage bonds or high quality corporate bonds, particularly for longer term, less liquid liabilities. An issue particular to the Euro zone is that Euro government bonds do not exist. Instead, each government within the Euro zone issues their own debt, which is subject to local market supply and demand issues and the market's view of the credit worthiness of the particular government. Thus, otherwise identical government bonds in the Euro zone will have different prices and yields. In CP 40, CEIOPS proposes to use the Euro curve derived by the European Central Bank ("ECB"). However, this fails the Realism principle because insurance undertakings cannot purchase assets that provide this yield. By contrast there is a single Euro swap-based term structure within the Euro zone. Therefore an 'AAA-rated' government bond-based term structure does not meet the realism structure, whereas swaps and other market-based alternatives for long term / illiquid liabilities would meet the realism principle.	
100.	Groupe	3.8.	The Level 1 directive does not specify that the risk-free rate has to	Not agreed. CEIOPS holds the

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	Consultatif		be earned in a risk-free manner. This paragraph goes significantly beyond the requirements of the directive.	view that undertakings should be able to earn the discount rate.
101.	Institut des actuaires (France)	3.8.	Read our comments made about paragraph 3.1.	So response to these comments.
102.	Legal & General Group	3.8.	The directive does not specify that the risk-free rate has to be earned in a risk-free manner. This paragraph goes significantly beyond the requirements of the directive. The focus should always be on the 1 in 200 risk whereas the CEIOPS approach seeks to raise this to nearer a "no failure" regime.	Not agreed. CEIOPS holds the view that undertakings should be able to earn the discount rate.
103.	Lucida plc	3.8.	We agree that it should be possible for all insurers to earn the risk-free rate in a risk-free manner. We note that this requires a deep and liquid market, which is not necessarily the case for all government bond markets.	Noted.
104.	OAC plc	3.8.	The directive does not specify that the risk-free rate has to be earned in a risk-free manner. This paragraph goes significantly beyond the requirements of the directive. The focus should always be on the 1 in 200 risk whereas the CEIOPS approach seeks to raise this to nearer a "no failure" regime.	Not agreed. CEIOPS holds the view that undertakings should be able to earn the discount rate. Please note that this refers to the expected profit, not including unexpected losses.
105.	PEARL GROUP LIMITED	3.8.	The Realism concept causes a conflict with stages two and three of the three stage approach for the derivation of the risk-free rate. E.g. for the UK a swap rate adjusted for credit risk is proposed. It will not be possible to earn this rate risk-free with assets available in the market. A company could buy swaps and incur credit risk, or government bonds for which the curve will be different.	Noted.
106.	RBS	3.8.	For all insurers to earn the specified returns as desired, the	Not agreed. The transaction cost

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	Insurance		specified risk free rate should be net of the average level of transaction/execution fees on transacting in government bonds, otherwise this could mean that small insurers who are not able to transact on a sufficient scale to keep costs low may be unable to earn the risk free rate that they are assuming in discounting reserves which could lead to the potential hidden losses mentioned.	or fees of investment activities should be allowed for in the cash-flows of the technical provisions. See clarification in the text.
107.	UNESPA (Association of Spanish Insurers)	3.8.	We understand that in practice, earning a specific "risk-free rate" implies the existence of financial instruments available to an insurer.	Noted.
108.	Association of British Insurers	3.9.	The swaps market benefits from many buyers and sellers and so is much less likely to suffer constraints upon supply and demand. On the other hand, government bonds are sold by just one agent and the supply of bonds is determined by funding requirements and monetary policy objectives. In the Euro area there are further problems because there is not a 'euro government bond' rather there are only individual national government bonds. Some are AAA-rated and may be deemed "risk free" but most are not AAA-rated and so would not meet the CP40 criteria. This would create many difficulties and distortions.	Noted.
109.	CEA, ECO-SLV-09-434	3.9.	The swaps market benefits from many buyers and sellers and so is much less likely to suffer constraints upon supply and demand. On the other hand, government bonds are sold by just one agent and the supply of bonds is determined by funding requirements and monetary policy objectives. In the Euro area there are further problems because there is not a 'euro government bond' rather there are only individual national government bonds. Some are AAA-rated and may be deemed "risk free" but most are not AAA-rated and so would not meet the CP40 criteria. This would create many difficulties and distortions.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
110.	CRO Forum	3.9.	We agree with the characteristic of reliability. We do not however see that there is a clear argument that AAA government bonds are more reliable than swaps. It is important to learn from the experience of the current financial crisis, but it is even more important to remember that the nature of potential future financial crises can be very different. It is not unreasonable to imagine situations where government bond yield curves are affected or distorted by, for example, government budget deficits or concentration of trading or issue at particular maturities.	Noted.
111.	Danish Insurance Association	3.9.	We agree that realism is an important and desired characteristic of a term structure. It must be possible to hedge the interest rate exposure - be it as part of the ongoing risk management activities or in the case of winding up. The market for AAA rated bonds is so small compared to the liability exposure by insurance companies that the heavy reliance by CEIOPS on those bonds could severely twist market conditions.	Not agreed. The use of AAA rated government bond rates as discount rates does not force undertakings to hold AAA rated government bonds.
112.	German Insurance Association – Gesamtverb and der D	3.9.	The swaps market benefits from many buyers and sellers and no specific constraints upon supply and demand so the market can reach equilibrium. On the other hand, government bonds are sold by just one agent and the supply of bonds is determined by funding requirements and monetary policy objectives. In the Euro area there are further problems because there is not a 'euro government bond' rather there are only individual national government bonds. Some are 'AAA-rated' and may be deemed "risk free" but most are not 'AAA-rated' and so would not meet the CP 40 criteria. This would create many difficulties and distortions.	Noted.
113.	Groupe Consultatif	3.9.	The requirement of reliability does not solve the problem of the term structure in times of market turbulence. Therefore a process about the definition and identification of market crisis and the decision on further actions has to be established.	Agreed. The three stage approach is sufficiently flexible to react to crisis situations.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
114.	Legal & General Group	3.9.	Reliability is a useful quality and as has been demonstrated by the current market turbulence the existing regulatory requirements have proved to be reliable, robust and have not resulted in pro-cyclicality.	Noted.
115.	OAC plc	3.9.	Reliability is a useful quality and as has been demonstrated by the current market turbulence the existing regulatory requirements have proved to be reliable, robust and not resulting in pro-cyclicality.	Noted.
116.	PricewaterhouseCoopers LLP	3.9.	There may be some question over the level of robustness of the data underlying the term structure given the likely volatility in the current economic environment.	Noted.
117.	AMICE	3.10.	AMICE members also agree that the "Highly liquid for all maturities" principle should be replaced by "Highly liquid for all relevant maturities"	Noted.
118.	Association of British Insurers	3.10.	A swaps-based risk-free term structure better meets this principle than an AAA-rated government bond-based term structure. We should highlight that swaps may not continue to meet this principle during extraordinary market circumstances (the same can obviously also be said for government bonds) in which case other instruments may provide an appropriate benchmark to derive a risk-adjusted yield for long term liabilities. Swaps can be created to meet demand, whereas the supply of government bonds is dependent on the borrowing needs of the government. Therefore, the use of government bond rates can result in significant distortions and technical bias. Other instruments such as corporate bonds and mortgage bonds may also be used in certain circumstances to meet the demand for assets to back insurance liabilities and the risk-free yield can be determined by adjusting the yields on these instruments to remove the	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			component related to credit risk.	
119.	CEA, ECO-SLV- 09-434	3.10.	A swaps-based risk-free term structure better meets this principle than an AAA-rated government bond-based term structure. We should highlight that swaps may not continue to meet this principle during extraordinary market circumstances (the same can obviously also be said for government bonds) in which other instruments may provide an appropriate benchmark to derive a risk-adjusted yield for long term liabilities. Swaps can be created to meet demand, whereas the supply of government bonds is dependent on the borrowing needs of the government. Therefore, the use of government bond rates can result in significant distortions and technical bias. Other instruments such as corporate bonds and mortgage bonds may also be used in certain circumstances to meet the demand for assets to back insurance liabilities and the risk-free yield can be determined by adjusting the yields on these instruments to remove the component related to credit risk.	Noted.
120.	CRO Forum	3.10.	Swap markets are more liquid than Government Bond markets (please note that the term liquidity stands for the liquidity of marketplaces here but in the context of the illiquidity premium it stands for the (il)liquidity of liabilities, see 3.30.). Hence, reliable market values are available when using swap rates. A supply/demand issue strongly materializes in the Government Bond market as issues of Governments do not really depend on the demand side. The supply and demand are much better linked in swap markets and hence less technical bias is present in the swap market. The requirement for liquidity is admirable for achieving reliability of rates. This means that the respective discount curve is suitable for liquid liabilities but not at the same time for illiquid liabilities, see	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			3.30.	
121.	Danish Insurance Association	3.10.	Liquidity is an essential and necessary feature that financial instruments from which the term structure is derived must possess. In the Danish case, this feature is not well met by government bonds, not least for longer maturities. The liquidity feature is one of reasons why the Danish term structure was originally built upon the euro swap market (and still is to some extent). The markets for mortgage bonds and euro swaps are much more liquid also in the longer maturities than the market for government bonds. For a while it has been the case that the yield on AAA rated government bonds has been higher than the euro swap yields for the longer maturities. This can hardly be explained by credit risk considerations. Rather, the negative swap spread can be attributed to different supply and demand conditions in the government bond and swap market. The example shows that CEIOPS is putting too much emphasis on the credit risk criterion.	Noted.
122.	Dutch Actuarial Society – Actuariële Genootschap (	3.10.	Change header: “d) Highly liquid for all maturities”	Noted.
123.	German Insurance Association – Gesamtverband der D	3.10.	A swaps-based risk-free term structure better meets this principle than an ‘AAA-rated’ government bond-based term structure for liquid liabilities. Other instruments may also provide an appropriate benchmark to derive a risk-adjusted yield for long term liabilities. Swaps can be created to meet demand, whereas the supply of government bonds is dependent on the borrowing needs of the	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			government. Therefore, the use of government bond rates can result in significant distortions and technical bias. Other instruments such as corporate bonds and mortgage bonds may also be used in certain circumstances to meet the demand for assets to back insurance liabilities and the risk-free yield can be determined by adjusting the yields on these instruments to remove the component related to credit risk.	
124.	Groupe Consultatif	3.10.	We agree in general terms with this point. We note that studies have suggested that the euro-denominated swap market is more homogeneous and liquid than corresponding government bond markets. This is evidenced by the much narrower range of spread. The swaps market is considerably larger deep and liquid market than the government bond markets for the major developed countries individual government bond markets. However, the underlying requirement should be that the liquidity of the assets and liabilities is similar, rather than just considering the assets. Euro-denominated swaps are typically significantly more liquid than government bonds, especially for longer maturities although beyond a long duration liquidity decreases. Swaps can be created to meet demand, whereas the supply of government bonds is dependent on the borrowing needs of the government, which can result in significant distortions and technical bias as is discussed in the following section.	Noted.
125.	Legal & General Group	3.10.	The swaps market is considerably larger, deeper and more liquid than the government bond markets for the major developed countries. However, the underlying requirement should be that the liquidity of the assets and liabilities is similar, rather than just considering the assets (as discussed in 3.5).	Noted.
126.	Lucida plc	3.10.	Where liabilities are illiquid, for example annuity liabilities, we	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			believe that a case can be argued for allowing for this illiquidity premium in deriving risk free rates. Hence in determining the risk free rate for these liabilities, illiquid assets would need to be considered.	
127.	Munich RE	3.10.	Swap markets are more liquid than Government Bond markets (please note that the term liquidity stands for the liquidity of marketplaces here but in the context of the illiquidity premium is stand for the (il)liquidity of liabilities, see 3.30.). Hence, reliable market values are available when using swap rates. A supply/demand issue strongly materializes in the Government Bond market as issues of Governments do not really depend on the demand side. The supply and demand are much better linked in swap markets and hence less technical bias is present in the swap market.	Noted.
128.	OAC plc	3.10.	The swaps market is a considerably larger deep and liquid market than the government bond markets for the major developed countries individual government bond markets. However, the underlying requirement should be that the liquidity of the assets and liabilities is similar, rather than just considering the assets.	Noted.
129.	PricewaterhouseCoopers LLP	3.10.	We caution that a "deep, liquid and transparent" market (as defined in Consultation Papers 39 and 41) may not be a realistic option for some currencies and more generally in situations of financial crisis.	Noted.
130.	Prof. Antoon Pelsser, Maastricht University	3.10.	Change header: "d) Highly liquid for all maturities"	Noted.
131.	Association of British Insurers	3.11.	20. The last bullet point: "the properties specified above are expected to be permanent" should be deleted.	Cf. CP 41.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			The conditions mentioned in the first and second bullet point are reasonable. However, one lesson from the current crisis is that it is not possible to answer the question whether a market will always meet these conditions but only whether it fulfils them now.	
132.	CEA, ECO-SLV-09-434	3.11.	15. The last bullet point: "the properties specified above are expected to be permanent" should be deleted. The conditions mentioned in the first and second bullet point are reasonable. However, one lesson from the current crisis is that it is not possible to answer the question whether a market will always meet these conditions but only whether it fulfils them now.	Cf. CP 41.
133.	German Insurance Association – Gesamtverb and der D	3.11.	The last bullet point: "the properties specified above are expected to be permanent" should be deleted. The conditions mentioned in the first and second bullet point are reasonable. However, one lesson from the current crisis is that it is not possible to answer the question whether a market will always meet these conditions but only whether it fulfils them now.	Cf. CP 41.
134.	Groupe Consultatif	3.11.	The definition of "liquid market" is still not well defined (how much is "large-volume") The last bullet point ("the properties specified above are expected to be permanent") should be deleted because it is unrealistic. This is one lesson from the current market crisis.	Cf. CP 41.
135.	CEA, ECO-SLV-09-434	3.12.	The relevance of these articles needs to be reconsidered as these articles are not principles but are very specific and are based on one point in time.	Noted.
136.	Dutch Actuarial Society –	3.12.	Include under d)	Noted.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	Actuarieel Genootschap (			
137.	German Insurance Association – Gesamtverband der D	3.12.	The relevance of these articles needs to be reconsidered as these articles are not principles but are very specific and are based on one point in time.	Noted.
138.	Groupe Consultatif	3.12.	This paragraph and the next two underline our argument against linking the risk-free rate term structure to any single class of instrument. Government bonds are often used as benchmarks with certain impact on the prices. Swaps are more liquid and therefore less exposed to technical bias, and they can be issued when imbalances between supply and demand occur. We would accept that current negative swap spreads at long durations confirm that all markets are subject to influence by weakly understood technical influences. In contrast, there is only one issuer of government bonds – the government. This exposes government bonds to supply and demand imbalances. As recent experience has shown, during times of market turbulence the government can rapidly change the supply of government debt through quantitative easing (“printing money”). There can also be times where governments issue relatively few bonds of specific maturities. Fundamentally the government bond market suffers from a supply constraint at times either of under or over supply. The swaps market does not suffer this constraint as it will expand or contract in line with supply and demand. Further this stands across all durations, whereas government bond markets can be distorted at	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			different durations and because the terms on particular bonds, for example coupon rate. Beyond about 10 years the government bond market may not be deep and liquid by the CEIOPS definitions and, for an observable curve, only swaps has appropriate reference points and at very long durations even the swap curve becomes inappropriate as an observable market consistent basis.	
139.	OAC plc	3.12.	Fundamentally the government bond market suffers from a supply constraint at times either under or over supply. The swaps market does not suffer this constraint as it will expand or contract in line with supply and demand. Further this stands across all durations, whereas government bond markets can be distorted at different durations and because the terms on particular bonds, for example coupon rate. In general and under QIS4 for terms less than 5 and maybe up to 10 years the government bond markets whilst not as liquid as swaps are deep and liquid and could be regarded as appropriate. An alternative would be to use either of the government bonds or the swaps curve with a small deduction for default risk. Historically, and before the recent market turmoil, this would have been in the order of 20/25 bps.and typically 50-75% of the yield gap. Beyond 10 years the government bond market is not deep and liquid by the CEIOPS definitions and, for an observable curve, only swaps has appropriate reference points and at very long durations even the swap curve breaks down as a basis for an observable market consistent basis.	Noted.
140.	Prof. Antoon Pelsser, Maastricht University	3.12.	Include under d)	Noted.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
141.	RBS Insurance	3.12.	Adjusting the observed yields for technical biases could be dangerous because it will never be quite clear what the scale of the bias is, and in removing it could lose the real shape of the unbiased yield curve. Smoothing/Graduation of the yield curve could be adopted here. Removing bias will result in the risk-free interest structure being less market consistent.	Noted. A bias should only be removed if strong evidence of it exists.
142.	ROAM – Draft V2	3.12.	CEIOPS advises that for the calculation of the best estimate “For each valuation date, the relevant risk-free interest rate term structure should be determined on the basis of market data relevant for the valuation date. » We disagree with this point. We consider that the relevant risk interest rate term structure should not depend on market data relevant for the valuation date. Indeed, this mark to market approach could not only lead to substantial changes in the value of liabilities due to there high volatility but also to procyclical effects. CEIOPS sets out in points 3.12 and 3.13 that government bond yield curve as well as the swap rates curve could lead to technical biases due to an artificially high demand from financial institutions and pension funds for specific durations. We consider that this artificially high demand from financial institutions and pension funds could also be raised by future Solvency II regulatory constraints if the relevant risk-free interest rate term structure is originated from market data relevant for the valuation date (mark to market approach). Indeed, as set out by The Norwegian Financial. Services Association: “[...] In a situation where an insurance company’s available capital is approaching SCR1, the prudent manager will move to lower the risk in the portfolio. Risk could be lowered by buying fixed income assets with a duration that is relevant to the	Not agreed. This approach is not in line with the Level 1 text.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		liabilities the company holds. Since the duration of pension liabilities tend to exceed 20 years, insurers demand will be for long duration instruments. These instruments are generally few and exposed to thin trading. Thus, the long-term end of the interest market is usually less liquid than the short end. The increased demand in long-term bonds will depress interest rates, creating a vicious circle when insurance companies have to reduce the risk even more as liabilities seem to increase in value, decreasing available capital.” For these reasons we consider that the best estimate should not depend on a risk-free interest rate term structure obtained with market data relevant for the valuation date (mark to market approach). Even IASB has recently taking initiatives to better respect economic valuation of assets in regard of stakeholders commitments structure and to reduce procyclical effects (ED/2009/7 Financial Instruments: Classification & Measurements). To do so, IASB decided that an entity using a ‘buy and hold’ investment policy - as a large part of long term insurance company – should value instruments producing predictable cash flows at their amortised cost rather than at their fair value. Therefore, for consistency of valuation between assets and commitments and to reduce volatility and procyclical effects of the method proposed in this Consultation Paper, we encourage CEIOPS to take into account not only a similar approach for the valuation of assets but also for the estimation of the best estimate. To do this, we propose to value the best estimate at its amortised cost when the underlying commitments have no surrender option. For the calculation of the best estimate, the futures cash flows estimated at the valuation date should be split up between their	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			subscriptions contracts years and then be actualised separately with the free interest rate term structure relevant for each subscription year.	
143.	Association of British Insurers	3.13.	Swaps are typically significantly more liquid than government bonds, especially beyond a five-year duration. This is the result of the large number of issuers of swaps and the fact that swaps can be created to ensure that supply meets demand. In contrast, there is only one issuer of government bonds – the government. This makes government bonds more prone to supply and demand imbalances. As recent experience has shown, during times of market turbulence, the government can rapidly change the supply of government debt through quantitative easing (“printing money”). There can also be times where governments issue relatively few bonds (as has been the case in the UK and other markets until recent times). Thus some political risk is introduced when using AAA-rated government bonds. Indeed the choice of financial instrument used to derive the risk-free term structure could itself cause supply and demand issues if that instrument is not very liquid. Under CEIOPS’ proposal AAA-rated government bonds would become the only risk-free matching asset and so there would be significantly (and artificially) increased demand for these assets from insurance undertakings wanting to match their liabilities and so reduce capital requirements. The use of any other asset in the insurer’s portfolio would introduce basis risk and so would act as a disincentive to hold this other asset, even if this were otherwise deemed to be “risk free”. For long term/illiquid assets, the provision of a diversity of risk-free assets would reduce over-reliance on one set of instruments and would reduce the risk of technical bias arising from supply/demand mismatch.	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			The greater liquidity of the swaps market and the greater number of issuers makes it significantly less likely to be distorted by technical bias compared to the 'AAA-rated' government bond market.	
144.	CEA, ECO-SLV- 09-434	3.13.	Swaps are typically significantly more liquid than government bonds, especially beyond a five-year duration. This is the result of the large number of issuers of swaps and the fact that swaps can be created to ensure that supply meets demand. In contrast, there is only one issuer of government bonds – the government. This makes government bonds more prone to supply and demand imbalances. As recent experience has shown, during times of market turbulence, the government can rapidly change the supply of government debt through quantitative easing ("printing money"). There can also be times where governments issue relatively few bonds (as has been the case in the UK and other markets until recent times). Thus some political risk is introduced when using AAA-rated government bonds. Indeed the choice of financial instrument used to derive the risk-free term structure could itself cause supply and demand issues if that instrument is not very liquid. Under Ceiops' proposal AAA-rated government bonds would become the only risk-free matching asset and so there would be significantly (and artificially) increased demand for these assets from insurance undertakings wanting to match their liabilities and so reduce capital requirements. The use of any other asset in the insurer's portfolio would introduce basis risk and so would act as a disincentive to hold this other asset, even if this were otherwise deemed to be "risk free". For long term/illiquid assets, the provision of a diversity of risk-free assets would reduce over-reliance on one set of instruments and would reduce the risk of technical bias arising from supply/demand	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			mismatch. The greater liquidity of the swaps market and the greater number of issuers makes it significantly less likely to be distorted by technical bias compared to the 'AAA-rated' government bond market. R We disagree with Ceiops' analysis of the technical bias existing in government bond markets and swap markets.	
145.	CRO Forum	3.13.	The high demand for the fixed swap leg shows that investors with fixed liabilities like insurers and pension funds use these instruments when valuing and hedging their liabilities. Hence, due to the general principle of pricing a transaction according to its transfer value, also swap rates should be used as risk free interest rates. Distortions due to supply and demand can occur when defining the Government as well as the swap rate as risk free rate. Consequently, this does not give an argument for one or the other curve. On the contrary we rather feel that we see a market distortion in the Government bond market these days. Another way of looking at the phenomenon of negative swap vs. government spreads is to state that at longer durations collateralised swaps are more secure than government debt, i.e. the issue is potential long term defaults by governments as debt increases as a percentage of GDP. Additionally, if swaps carry significant credit risk and carry a lower yield than supposedly risk-free government bonds why would a rational investor buy them? The possible reasons for a strong swap markets are; R government bonds could carry more credit risk than swaps; R swaps are more liquid (lower trading costs, no limit on supply);	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			R government bonds (over supply pushing up yields) and swaps rates (very high demand as it is the market instrument of choice for investors) are affected by distortions. All of these potentially support swaps being used over gilts as the risk-free rate for liquid liabilities.	
146.	Dutch Actuarial Society – Actuarieel Genootschap (	3.13.	Include under d)	Noted.
147.	German Insurance Association – Gesamtverband der D	3.13.	Swaps are typically significantly more liquid than government bonds, especially beyond a five-year duration. This is a result of the large number of issuers of swaps and the fact that swaps can be created to ensure that supply meets demand. In contrast, there is only one issuer of government bonds – the government. This makes government bonds more prone to supply and demand imbalances. As recent experience has shown, during times of market turbulence, the government can rapidly change the supply of government debt through quantitative easing (“printing money”). There can also be times where governments issue relatively few bonds (as has been the case in the UK and other markets until recent times). Thus some political risk is introduced when using AAA-rated government bonds. Indeed the choice of financial instrument used to derive the risk-free term structure could itself cause supply and demand issues if that instrument is not very liquid. Under CEIOPS’ proposal ‘AAA-rated’ government bonds would become the only risk-free matching asset and so there would be significantly (and artificially) increased	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			demand for these assets from insurance undertakings wanting to match their liabilities and so reduce capital requirements. The use of any other asset would introduce basis risk and so would act as a disincentive to hold this other asset, even if this were otherwise deemed to be "risk free". For long term/illiquid assets, the provision of a diversity of risk-free assets would reduce over-reliance on one set of instruments and would reduce the risk of technical bias arising from supply/demand mismatch. The greater liquidity of the swaps market and the greater number of issuers makes it significantly less likely to be distorted by technical bias compared to the 'AAA-rated' government bond market. R We disagree with CEIOPS' analysis of the technical bias existing in government bond markets and swap markets.	
148.	Groupe Consultatif	3.13.	The statements made also illustrate that there is technical bias in the government bond markets. Other things being equal if it was possible to carry out the required transactions using government bonds then the yield difference between swaps and government bonds would be considerably reduced. It is the inflexibility of the government bond markets to efficiently manage for example interest rate risk that has resulted in the development of the swaps market. This demonstrates the limitations of using government bonds as the basis for the risk free rate in both normal and distorted market conditions.	Noted.
149.	Munich RE	3.13.	The high demand for the fixed swap leg shows that investors with fixed liabilities like insurers and pension funds use these instruments when valuing and hedging their liabilities. Hence, due	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			to the general principle of pricing a transaction according to its transfer value, also swap rates should be used as risk free interest rates. Distortions due to supply and demand can occur when defining the Government as well as the swap rate as risk free rate. Consequently, this does not give an argument for one or the other curve. On the contrary we rather feel that we see a market distortion in the Government bond market these days.	
150.	OAC plc	3.13.	The statements made also illustrate that there is technical bias in the government bond markets. Other things being equal if it was possible to carry out the required transactions using government bonds then the yield difference between swaps and government bonds would be considerably reduced. It is the inflexibility of the government bond markets to efficiently manage for example interest rate risk that has resulted in the development of the swaps market. This demonstrates the limitations of using government bonds as the basis for the risk free rate in both normal and distorted market conditions.	Noted.
151.	Prof. Antoon Pelsser, Maastricht University	3.13.	Include under d)	Noted.
152.	UNESPA (Association of Spanish Insurers)	3.13.	Technique deviations discussed here are also applicable to government bonds; the distortion of the supply affect in a deeper way to the governments as they are obliged to increase their debt issues due to the current situation. All the developed economies will have a representative swap curve, so for those ones it will work the use of the swap curve. In the economics areas where the swap curve can not be considered deeply enough, it should be recommended the use of other curves.	Noted.
153.	Association	3.14.	Significant distortions could arise if the risk-free rate is derived	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	of British Insurers		using AAA-rated government bonds A potential problem with basing the Eurozone risk-free term structure on government bonds is that only short term interest rates are common throughout the Eurozone, with long term government yields in each country being a function of supply and demand in that country's market. For example, there can be significant differences in the level and volatility of the yields on German government bonds compared to the yields of Irish or Italian government bonds. If, as proposed in CP40, a common Eurozone risk-free rate were to be derived using AAA-rated government bonds, which in practice means largely German and French bonds, then an insurance company in the eurozone looking for risk-free assets to match its liabilities is likely to purchase German or French bonds in preference to its own government bonds. The difficulties arising from this approach are discussed in depth above, but could result in major funding problems for many governments and significant distortions in the risk-free rate used to value insurers' liabilities.	
154.	CEA, ECO-SLV-09-434	3.14.	A level playing field should be ensured. In our opinion the methodology and principles chosen should be available for all relevant currencies ensuring consistency and a level playing field. Therefore, it is of vital importance that the same level of detail is provided under Level 2 for all currencies in order to ensure a level playing field is retained. CP40 currently provides different levels of guidance for the Euro relative to non-Euro currencies. It is important that this is not the case in the final version of Level 2, which should provide guidance to the same level of detail for all currencies.	Not agreed. Owing to the large number of global currencies it seems not possible to specify the same level of detail for each currency. The relevance of the currencies for the European insurance market should be taken into account.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			Significant distortions could arise if the risk-free rate is derived using AAA-rated government bonds Risk-free term structures will be required in all countries covered by Solvency II to enable technical provisions to be calculated. This is not the same as requiring availability in all currencies because the Euro currency is common to a number of countries. Applying a discount rate which calculation is based on the same techniques for all currencies will ensure consistency among undertakings and avoid market distortions. A potential problem with basing the Eurozone risk-free term structure on government bonds is that only short term interest rates are common throughout the Eurozone, with long term government yields in each country being a function of supply and demand in that country's market. For example, there can be significant differences in the level and volatility of the yields on German government bonds compared to the yields of Irish or Italian government bonds. If, as proposed in CP40, a common Eurozone risk-free rate were to be derived using AAA-rated government bonds, which in practice means largely German and French bonds, then an insurance company in the eurozone looking for risk-free assets to match its liabilities is likely to purchase German or French bonds in preference to its own government bonds. The difficulties arising from this approach are discussed in depth above, but could result in major funding problems for many governments and significant distortions in the risk-free rate used to value insurers' liabilities.	
155.	CRO Forum	3.14.	Where companies have businesses in territories where swap curves are not available or do not provide a robust basis for producing risk free rates then a more appropriate alternative, such as the	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			government bond yield curve, could be used. Nevertheless, any alternative should be evaluated based on the criteria as described in this CP.	
156.	Dutch Actuarial Society – Actuarieel Genootschap (	3.14.	Move to “implementation section”	Noted.
157.	German Insurance Association – Gesamtverband der D	3.14.	A level playing field should be ensured In our opinion the methodology and principles chosen should be available for all relevant currencies ensuring consistency and a level playing field. Therefore, it is of vital importance that the same level of detail is provided under Level 2 for all currencies in order to ensure a level playing field is retained. CP40 currently provides different levels of guidance for the Euro relative to non-Euro currencies. It is important that this is not the case in the final version of Level 2, which should provide guidance to the same level of detail for all currencies. Significant distortions could arise if the risk-free rate is derived using AAA-rated government bonds Risk-free term structures will be required in all countries covered by Solvency II to enable technical provisions to be calculated. This is not the same as requiring availability in all currencies because the Euro currency is common to a number of countries. A potential problem with basing the Euro zone risk-free term structure on government bonds is that only short term interest	Not agreed. Owing to the large number of global currencies it seems not possible to specify the same level of detail for each currency. The relevance of the currencies for the European insurance market should be taken into account.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			rates are common throughout the Euro zone, with long term government yields in each country being a function of supply and demand in that country's market. For example, there can be significant differences in the level and volatility of the yields on German government bonds compared to the yields of Irish or Italian government bonds for instance. If, as proposed in CP40, a common Euro zone risk-free rate were to be derived using 'AAA-rated' government bonds, which in practice means largely German and French bonds, then an insurance company in the Euro zone looking for risk-free assets to match its liabilities is likely to purchase German or French bonds in preference to its own government bonds. The difficulties arising from this approach are discussed in depth above, but could result in major funding problems for many governments and significant distortions in the risk-free rate used to value insurers' liabilities.	
158.	Groupe Consultatif	3.14.	(-3.18) It maybe needs to be emphasised that the relevant currency/rate to be used is determined by the currency in which the liability is defined (and not where the assets are held, or where the insurer is located) Risk-free term structures will be used in all countries covered by Solvency II. Since there are considerable differences between the economies of these countries, the claim of one instrument for all currencies is hardly realisable. If, as proposed in CP40, a common EUR-AAA-government bond term structure is used, which in practice means largely German and French bonds, then an insurance company in the Eurozone looking for risk-free assets to match its liabilities may therefore be likely to purchase German or French bonds in preference to its own government bonds. This would introduce a basis risk for insurance companies from other countries than Germany and France and	Agreed. Cf. paragraph 3.48 of the CP. Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			could result in major funding problems for many governments and significant distortions in the risk-free rate used to value the liabilities.	
159.	Munich RE	3.14.	Where companies have businesses in territories where swap curves are not available or do not provide a robust basis for producing risk free rates then a more appropriate alternative, such as the government bond yield curve, could be used. Nevertheless, any alternative should be evaluated based on the criteria described in this CP.	Noted.
160.	PricewaterhouseCoopers LLP	3.14.	We also refer to our comment on paragraph 3.121 of Consultation Paper 39 which states: "The principles of materiality and proportionality should be applied in the valuation of technical provisions separately by currency. Simplifications should be permitted so that separate currency projections are only required where amounts denominated in secondary currencies are material."	Noted.
161.	Prof. Antoon Pelsser, Maastricht University	3.14.	Move to "implementation section"	Noted.
162.	CEA, ECO-SLV-09-434	3.15.	See comments to Para 3.14.	See resolutions of these comments.
163.	Danish Insurance Association	3.15.	The risk of allowing for different term structures between currencies should not be overstated. While securing a level playing field is important, for smaller markets it is most important that the term structure reflects financial instruments which are actively held in risk minimizing portfolios and would be held in case of financial distress. A level playing field is important, but while the massive	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			inflow of government money in banking may unlevel the playing field between banking and insurance, the problem identified in 3.15 seems to be far less important in practice.	
164.	Dutch Actuarial Society – Actuariële Genootschap (	3.15.	Move to “implementation section”	Noted.
165.	German Insurance Association – Gesamtverband der D	3.15.	See comments to Para 3.14	See resolutions of these comments.
166.	PricewaterhouseCoopers LLP	3.15.	See comments under 3.14	See resolutions of these comments.
167.	Prof. Antoon Pelsser, Maastricht University	3.15.	Move to “implementation section”	Noted.
168.	CEA, ECO-SLV-09-434	3.16.	See comments to Para 3.14.	See resolutions of these comments.
169.	Dutch Actuarial Society – Actuariële	3.16.	Move to “implementation section”	Noted.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	Genootscha p (			
170.	German Insurance Association – Gesamtverband der D	3.16.	See comments to Para 3.14	See resolutions of these comments.
171.	Just Retirement Limited	3.16.	Differences in interest rate term structures are likely to be reflected in forward exchange rates.	Noted. The comparison is made between products in different currencies.
172.	OAC plc	3.16.	Insurance contracts have fundamental risks however it is vital that those risks are not artificially distorted by the regulatory systems increasing or amplifying them. As would be recognised through the ORSA the regulatory system can not reduce the risk below those fundamental risks. It is therefore the calibration of the regulatory system mis-aligned with the fundamental risks of insurance contracts that creates the risk of a non-level playing field.	Noted.
173.	PricewaterhouseCoopers LLP	3.16.	See comments under 3.14	See resolutions of these comments.
174.	Prof. Antoon Pelsser, Maastricht University	3.16.	Move to "implementation section"	Noted.
175.	CEA, ECO-SLV-09-434	3.17.	See comments to Para 3.14.	See resolutions of these comments.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
176.	Dutch Actuarial Society – Actuariel Genootschap (	3.17.	Move to “implementation section”	Noted.
177.	German Insurance Association – Gesamtverband der D	3.17.	See comments to Para 3.14	See resolutions of these comments.
178.	Legal & General Group	3.17.	Achieving the same degree of “risk-freeness” is desirable; however, this should not be at the expense of the regulatory system ignoring the fundamental risks of insurance contracts. For example, if you have two identical annuity contracts, one with a surrender option and one without, the technical provisions and the capital requirements should be different to reflect the significantly different risks.	Noted.
179.	OAC plc	3.17.	Achieving the same degree of risk-freeness is desirable; however, this should not be at the expense of the regulatory system changing the fundamental risks of insurance contracts. For example if you have two identical annuity contracts one with a surrender option and one without the technical provisions and capital requirements should be fundamentally different to reflect the significantly different risks.	Noted.
180.	PricewaterhouseCoopers LLP	3.17.	See comments under 3.14	See resolutions of these comments.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
181.	Prof. Antoon Pelsser, Maastricht University	3.17.	Move to "implementation section"	Noted.
182.	CEA, ECO-SLV-09-434	3.18.	See comments to Para 3.14.	See resolutions of these comments.
183.	Dutch Actuarial Society – Actuariële Genootschap (	3.18.	Move to "implementation section"	Noted.
184.	German Insurance Association – Gesamtverband der D	3.18.	See comments to Para 3.14	See resolutions of these comments.
185.	PricewaterhouseCoopers LLP	3.18.	There may be some degree of subjectivity regarding the ability to show the same degree of risk-freeness in the term structure. See also comments under 3.14	Noted.
186.	Prof. Antoon Pelsser, Maastricht University	3.18.	Move to "implementation section"	Noted.
187.	Association of British	3.19.	Whilst it may be helpful for small entities to be provided with the term structure (as a simplification where they are not able to	Not agreed. For reasons of proportionality and in order to

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	Insurers		perform the necessary calculations) we believe that the supervisors role is to provide appropriate guidance and define parameters to derive the relevant discount rates, whilst markets should provide price information.	ensure comparable and significant technical provisions, the risk-free term structure should be specified by a central institution.
188.	CEA, ECO-SLV-09-434	3.19.	Although the text in 3.19 – 3.21 is relevant, the principle (g) proportionality is not a principle and should be removed from the list. The risk free rate should reflect the characteristics of the insurance contracts which are to be discounted. This is in line with article 76(2) which states “.., taking into account of the time value of money (expected present value of future cash flows) using the relevant risk free interest rate term structure.” In our opinion the word relevant is to be read in conjunction with the cash flows and should reflect the (specific) characteristics.	Partly agreed. See revised text.
189.	Dutch Actuarial Society – Actuariële Genootschap (	3.19.	Move to “implementation section”	Noted.
190.	German Insurance Association – Gesamtverband der D	3.19.	Although the text in Para 3.19 – 3.21 is relevant, the principle (g) proportionality is not a principle and should be removed from the list. The risk free rate should reflect the characteristics of the insurance contracts which are to be discounted. This is in line with article 76(2) which states “... taking into account of the time value of money (expected present value of future cash flows) using the relevant risk free interest rate term structure.” In our opinion the word relevant is to be read in conjunction with	Partly agreed. See revised text.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			the cash flows and should reflect the (specific) characteristics.	
191.	Groupe Consultatif	3.19.	We agree with CEIOPS that it is necessary to provide both the term structure and the methodology used to derive the term structure both for all EEA currencies and for major non-EEA currencies.	Noted.
192.	Lloyd's	3.19.	The paragraph suggests that the proportionality principles will not apply and states that choice of the risk-free rate should not depend on the nature, scale and complexity of the risks of the undertaking. We strongly disagree. For small sub-portfolios in minor currencies, or for very short duration liabilities (where discounting is minimal), the firm should have some discretion to make approximations in the derivation of the risk free rate.	Not agreed. If the term structure is provided there is no need for approximations.
193.	Lucida plc	3.19.	We believe that insurers should be permitted to use different rates in particular circumstances, for example where liabilities are illiquid. This is contrary to 3.19.	Partly agreed. See revised text.
194.	OAC plc	3.19.	It is not useful or desirable for the choice of risk free rate to not depend on the nature, scale and complexity of the risks of the undertaking if this results in a fundamental change to the inherent risks. Therefore the choice of risk free rate should only not depend on the nature, scale and complexity of the risks if it does not cause a fundamental distortion of those risks.	Partly agreed. See revised text.
195.	Prof. Antoon Pelsser, Maastricht University	3.19.	Move to "implementation section"	Noted.
196.	Uniqa	3.19.	We explicit support CEIOPS approach to provide the term structure and the methodology.	Noted.
197.	Association of British Insurers	3.20.	See comment to 3.19. Markets provide data on a continuous basis.	Noted.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
198.	CEA, ECO-SLV-09-434	3.20.	We believe the term structure should be provided more frequently than on a quarterly basis. Providing the term structure on a quarterly basis does not seem sufficient. In our opinion, the term structure which is to be used should be available on a continuous basis and should readily observable.	Not agreed. There may be practical constraints to providing the term structure more often. However, please note that the ECB yield curve is available on a daily basis.
199.	CRO Forum	3.20.	Comment refers to the following statement: "The risk-free interest rate term structure of the EEA currencies should be provided at least on a quarterly basis." The CRO Forum believes that this frequency is not sufficient for Asset Liability Management, and should therefore be provided as a minimum on a daily basis.	Not agreed. There may be practical constraints to providing the term structure more often. However, please note that the ECB yield curve is available on a daily basis.
200.	Danish Insurance Association	3.20.	Providing the term structure on a quarterly basis is not very ambitious. In Denmark, it is provided on a daily basis.	Not agreed. There may be practical constraints to providing the term structure more often. However, please note that the ECB yield curve is available on a daily basis.
201.	Dutch Actuarial Society – Actuariële Genootschap	3.20.	Move to "implementation section"	Noted.
202.	German Insurance Association – Gesamtverb	3.20.	We believe the term structure should be provided more frequently than on a quarterly basis Providing the term structure on a quarterly basis does not seem sufficient. In our opinion, the term structure which is to be used	Not agreed. There may be practical constraints to providing the term structure more often. However, please note that the ECB yield curve is available on a

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	and der D		should be available on a continuous basis and should readily observable.	daily basis.
203.	Groupe Consultatif	3.20.	Insurance firms do not only have reporting dates that coincide with only quarter ends. It is assumed that the intention of providing the risk-free interest rate term structure is that these rates and only these rates are used for reporting purposes. Given the different reporting dates of firms and that they do not all coincide with quarter or month ends then only supplying daily risk-free interest rate term structures to meet this objective in all conditions. The recent crisis illustrated that interbank rates on which swap-based yields are based can be subject to particular distortion at certain dates (such as year-end) although this is unusual.	Not agreed. There may be practical constraints to providing the term structure more often. However, please note that the ECB yield curve is available on a daily basis.
204.	Just Retirement Limited	3.20.	It would be more helpful if term structures were provided on a monthly basis, to allow those entities wishing to undertake calculations at that frequency to do so, for example to demonstrate on-going solvency between formal valuation dates. It is also inevitable that formal reporting dates are not aligned across all insurers, therefore term structures would need to be provided at a wide range of dates anyway – month end dates as a minimum, but (perhaps better) daily rates would avoid any potential problems.	Not agreed. There may be practical constraints to providing the term structure more often. However, please note that the ECB yield curve is available on a daily basis.
205.	Legal & General Group	3.20.	Insurance firms do not only have reporting dates that coincide with quarter ends. Daily risk free rates will be required.	Not agreed. There may be practical constraints to providing the term structure more often. However, please note that the ECB yield curve is available on a daily basis.
206.	Lucida plc	3.20.	We welcome the intent to provide the risk-free interest rate term structure on at least a quarterly basis though observe that insurers	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			should be permitted to use different rates in particular circumstances, for example where liabilities are illiquid. This comment also applies to 3.52	
207.	OAC plc	3.20.	Insurance firms do not only have reporting dates that coincide with only quarter ends. It is assumed that the intention of providing the risk-free interest rate term structure is that these rates and only these rates are used for reporting purposes. Given the different reporting dates of firms and that they do not all coincide with quarter or month ends then only supplying daily risk-free interest rate term structures to meet this objective in all conditions. In essence using yields available on a quarter end, and especially at 31.12 date means using data that is not deep or liquid. Such data is also likely to be volatile.	Not agreed. There may be practical constraints to providing the term structure more often. However, please note that the ECB yield curve is available on a daily basis.
208.	Prof. Antoon Pelsser, Maastricht University	3.20.	Move to "implementation section"	Noted.
209.	RBS Insurance	3.20.	The risk free term structure of the EEA countries should be provided at least quarterly by the ECB with the methodology also being published to allow those companies that reserve more frequently than quarterly to derive the term structure. Would this be provided by the BOE in the UK? We believe the frequency of provision of the term structure should be consistent in all member states. Does the internal asset model have to be fully consistent with any issued risk free term structures?	Noted.
210.	Dutch Actuarial Society –	3.21.	Move to "implementation section"	Noted.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	Actuarieel Genootschap (			
211.	Institut des actuaires (France)	3.21.	The simplest solution would be to publish a risk-free interest rate term structure for each currency.	Not agreed. Owing to the large number of global currencies it seems not possible to specify the same level of detail for each currency. The relevance of the currencies for the European insurance market should be taken into account.
212.	Legal & General Group	3.21.	At present, a firm's choice of interest rate for discounting liabilities is subject to audit whether for statutory returns or accounts. Therefore the choice is subject to a robust challenge process, separate and on a more timely basis than from the supervisor. A published methodology on the approach to be followed to determine the term structure(s) that takes into account the nature, scale and complexity of the risks would be useful.	Noted.
213.	OAC plc	3.21.	As at present a firm's choice of interest rate for discounting liabilities is subject to audit whether for statutory returns or accounts and therefore the choice is already subject to a robust challenge process	Noted.
214.	Prof. Antoon Pelsser, Maastricht University	3.21.	Move to "implementation section"	Noted.
215.	AMICE	3.22.	CEIOPS gives different options for the derivation of the risk-free rates: - Government bonds	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			- Government bonds + adjustment for technical bias - Swap rates - Swap rates minus adjustment for credit risk AMICE prefers Swap Rates as the best approximation for the risk-free rates.	
216.	Association of British Insurers	3.22.	The list of possible options available and their considerations for the risk-free rate is not complete The Commission also proposed a combination of the option (a) to (d). However CEIOPS has not assessed this option. Furthermore, CEIOPS defines four options and interprets the options as used by the Commission in a different manner. For swaps, the adjustment need not be limited only to a credit risk adjustment. The discount rate must also reflect the characteristics of the insurance liabilities in order to be relevant and so this will mean in the case of illiquid liabilities and appropriate adjustment.	Noted. It does not seem possible to provide a complete list of financial instruments that could theoretically be used to derive the term structure.
217.	ASSOCIATION OF FRIENDLY SOCIETIES (AFS)	3.22.	We would suggest that this table should be replaced with a table stating that swap rates or AAA government bond rates can be used.	Not agreed. Swap rates are not risk-free.
218.	CEA, ECO-SLV-09-434	3.22.	The list of possible options available and their considerations for the risk-free rate is not complete. The EC also proposed a combination of the option (a) to (d). However Ceiops has not argued or assessed this option. One possible combination could be to use the swap rate which is benchmarked by the local government bond rate e.g. the former may be not lower than the latter.	Noted. It does not seem possible to provide a complete list of financial instruments that could theoretically be used to derive the term structure.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			Furthermore, Ceiops defines four options and interprets the options as used by the EC in a different manner. For the swaps the EC mentions another option to allow for an adjustment. However they do not explicitly imply only a credit risk adjustment. In our opinion this issue should be assessed in full and not be limited to the adjustment for credit risk. The discount rate should reflect the characteristics of the insurance liabilities in order to be relevant. We should also add that in some market other alternatives may be readily available. In Denmark for example, the current term structure is to some extent derived from options adjusted mortgage bonds, providing a sound proxy for the risk free interest rate which helped the Danish market counter pro-cyclical effects during the financial crisis.	
219.	CRO Forum	3.22.	We advocate swap rate plus an illiquidity premium, i.e. an adjusted third option. More information regarding the liquidity premium will be provided once the respective working groups of the CRO and CFO Forum have come up with their recommendations (see also 3.30).	Noted.
220.	Danish Insurance Association	3.22.	In some markets – like in Denmark – other alternatives may be readily available. Our current term structure is to some extent derived from options adjusted mortgage bonds, providing a sound proxy for the risk free interest rate which has helped counter negative procyclical effects during the financial crisis.	Noted. It does not seem possible to provide a complete list of financial instruments that could theoretically be used to derive the term structure.
221.	Dutch Actuarial Society – Actuarieel Genootscha	3.22.	Section 3.1.2. should start with a paragraph that states the principles a)-d) (or e) are leading. And that based on the market circumstances one chooses a curve that best fits the risk-free rate criteria. This is now mentioned as an “afterthought” in 3.29, but we feel this should be a core starting point.	Noted.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	p (			
222.	German Insurance Association – Gesamtverb and der D	3.22.	The list of possible options available and their considerations for the risk-free rate is not complete The EC also proposed a combination of the option (a) to (d). However CEIOPS has not argued or assessed this option. One possible combination could be to use the swap rate which is benchmarked by the local government bond rate e.g. the former may be not lower than the latter. Furthermore, CEIOPS defines four options and interprets the options as used by the EC in a different manner. For the swaps the EC mentions another option to allow for an adjustment. However they do not explicitly imply only a credit risk adjustment. In our opinion this issue should be assessed in full and not be limited to the adjustment for credit risk. The discount rate should reflect the characteristics of the insurance liabilities in order to be relevant. We should also add that in some market other alternatives may be readily available. In Denmark for example, the current term structure is to some extent derived from options adjusted mortgage bonds, providing a sound proxy for the risk free interest rate which helped the Danish market counter pro-cyclical effects during the financial crisis.	Noted. It does not seem possible to provide a complete list of financial instruments that could theoretically be used to derive the term structure.
223.	Groupe Consultatif	3.22.	We note that these options are not necessarily mutually exclusive, that there are spreads related to government debt even in the same currency and that various forms of swap with differently specified floating legs exist. For the calculation of the best estimate different term structures may be relevant even at the same time. In the case of hedgeable risks (when replicating portfolios with respect to the major risks can be constructed) swap rates are more relevant, because capital	Noted. Not agreed. Hedging instruments are not valued on a risk-free basis.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			markets value hedging instruments on the basis of swap rates.	
224.	Institut des actuaires (France)	3.22.	This matter should be investigated by the special task force (see general comments).	Noted.
225.	Investment & Life Assurance Group (ILAG)	3.22.	We would suggest that this table should be replaced with a table stating that swap rates or AAA government bond rates can be used.	Not agreed. Swap rates are not risk-free.
226.	Legal & General Group	3.22.	We fundamentally disagree with this paragraph. The main options should include the yield on different portfolios of assets less an adjustment for credit risk or default risk as appropriate to the liabilities.	Noted. It does not seem possible to provide a complete list of financial instruments that could theoretically be used to derive the term structure.
227.	Lucida plc	3.22.	We would suggest that more consideration is paid to the alternatives to Bond Rates/Swap Rates. Recent research has suggested that SONIA/EONIA rates might be an appropriate rate to use.	Noted. It does not seem possible to provide a complete list of financial instruments that could theoretically be used to derive the term structure.
228.	Munich RE	3.22.	We advocate swap rate plus an illiquidity premium for liabilities that cannot be cancelled at short notice.	Not agreed. Swap rates are not risk-free.
229.	OAC plc	3.22.	We fundamentally disagree with this paragraph. The main options should include the yield on different portfolios of assets minus an adjustment for credit risk or default risk as appropriate to the liabilities.	Noted. It does not seem possible to provide a complete list of financial instruments that could theoretically be used to derive the term structure.
230.	PricewaterhouseCoopers LLP	3.22.	We agree these are the four main options to derive the risk free interest rate structure.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
231.	Prof. Antoon Pelsser, Maastricht University	3.22.	Section 3.1.2. should start with a paragraph that states the principles a)-d) (or e) are leading. And that based on the market circumstances one chooses a curve that best fits the risk-free rate criteria. This is now mentioned as an "afterthought" in 3.29, but I feel this should be a core starting point.	Noted.
232.	ROAM – Draft V2	3.22.	CEIOPS gives different options for the derivation of the risk-free rates : - Government bonds - Government bonds + adjustment for technical bias - Swap rates - Swap rates minus adjustment for credit risk We prefer Option 3 to be selected: Swap Rates	Noted.
233.	UNESPA (Association of Spanish Insurers)	3.22.	See comments to Para 3.54	See resolution of these comments.
234.	Association of British Insurers	3.23.	We do not agree that the "no credit risk" criterion is necessarily the most important. CEIOPS makes no justification for emphasising the credit risk criterion as superior to all other criteria. The main objective should be to derive a term structure which possesses a sound mixture of all the required criteria.	Not agreed. The Level 1 text requires the discount rates to be risk-free.
235.	CEA, ECO-SLV-09-434	3.23.	We do not agree that the "no credit risk" criterion is necessarily the most important. Ceioms makes no justification for emphasising the credit risk criterion as superior to all other criteria. The main objective should	Not agreed. The Level 1 text requires the discount rates to be risk-free.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			be to derive a term structure which possesses a sound mixture of all the required criteria.	
236.	CRO Forum	3.23.	The main objective should be no own credit risk to avoid wrong incentives, i.e. better liquidity situation when the default probability and hence the spread of the company increases. A proxy for the risk free curve has to be found.	Not agreed. The Level 1 text requires the discount rates to be risk-free.
237.	Danish Insurance Association	3.23.	CEIOPS makes no justification for emphasising the credit risk criterion as superior to all other criteria. The main objective should be to derive a term structure which possesses a sound mixture of all the required criteria.	Not agreed. The Level 1 text requires the discount rates to be risk-free.
238.	German Insurance Association – Gesamtverb and der D	3.23.	We do not agree that the “no credit risk” criterion is necessarily the most important. CEIOPS makes no justification for emphasising the credit risk criterion as superior to all other criteria. The main objective should be to derive a term structure which possesses a sound mixture of all the required criteria.	Not agreed. The Level 1 text requires the discount rates to be risk-free.
239.	Groupe Consultatif	3.23.	Minimal credit spread as the main objective for the risk free term structure yields several problems in practice; see 3.3 and the discussions above (in 3.8, 3.10, 3.12, 3.14).	Not agreed. The Level 1 text requires the discount rates to be risk-free.
240.	Legal & General Group	3.23.	This paragraph goes significantly beyond the level 1 directive. Including as little credit or default risk as possible is not the same thing as including as little credit spread as possible. We therefore fundamentally disagree that AAA rated government bonds should serve as a benchmark for all liabilities. The aim of Solvency II is to meet a confidence level of 99.5% and CP 40 risk free yield calibration on its own exceeds this target for annuities in the UK and similar products in other jurisdictions.	Not agreed. The Level 1 text requires the discount rates to be risk-free.
241.	OAC plc	3.23.	This paragraph goes significantly beyond the Directive. Including	Not agreed. The Level 1 text

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			as little credit or default risk as possible is not the same thing as including as little credit spread as possible. We therefore fundamentally disagree that AAA rated government bonds should serve as a benchmark for all liabilities. The aim of S II is to meet a 1:200 event and CP 40 on its own exceeds this target for annuities in the UK and similar products in other jurisdictions.	requires the discount rates to be risk-free.
242.	UNESPA (Association of Spanish Insurers)	3.23.	See comments to Para 3.54	See resolution of these comments.
243.	Uniga	3.23.	The use only of AAA rated Bonds means a divergence to the Market Risk Module. For spread risk, all bonds of OECD and EEA countries are exempted, not only AAA. So as there is no major risk for government bonds in the OECD or EEA, they can be used also as basis for the interest rate curve.	Noted.
244.	Dutch Actuarial Society – Actuariële Genootschap	3.24.	Alternative text: In cases where government bonds are inappropriate, for example because of technical bias, liquidity considerations or insufficient data-points for long maturities, the risk-free term structure should be approximated by means of instruments which are most in line with the risk-free rate criteria.	Not agreed. It is preferable to derive the risk-free rates from government bonds.
245.	Groupe Consultatif	3.24.	Technical bias and liquidity considerations are by definition always present in all government bond markets as supply is limited and governments often have taxation or other policies to make government bonds more financially attractive than a headline comparison of the yields. It should always be remembered that government bond policies are not to produce a “perfect market” but to fund debt at a low rate	Not agreed. We are no indications of a technical bias in the ECB yield curve.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			as possible. Inevitably this creates a tension with a pure market approach. On top of this key "benchmark" terms such as 10, 15, 20 years durations are biased through their use as a benchmark where demand is likely to be artificially increased.	
246.	Institut des actuaires (France)	3.24.	This matter should be investigated by the special task force (see general comments).	Noted.
247.	Legal & General Group	3.24.		Noted.
248.	OAC plc	3.24.	Technical bias and liquidity considerations are by definition always present in all government bond markets as supply is limited and governments often have taxation or other policies to make government bonds more financially attractive than a headline comparison of the yields. It should always be remembered that government bond policies are not to produce a "perfect market" but to fund debt at a low a rate as possible. Inevitably this creates a tension with a pure market approach. On top of this key "benchmark" terms such as 10, 15, 20 years durations are biased through there use as a benchmark where demand is likely to be artificially increased.	Not agreed. We are no indications of a technical bias in the ECB yield curve.
249.	Prof. Antoon Pelsser, Maastricht University	3.24.	Alternative text: In cases where government bonds are inappropriate, for example because of technical bias, liquidity considerations or insufficient data-points for long maturities, the risk-free term structure should be approximated by means of instruments which are most in line with the risk-free rate criteria.	Not agreed. It is preferable to derive the risk-free rates from government bonds.
250.	UNESPA (Association	3.24.	See comments to Para 3.54	See resolution of these comments.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	of Spanish Insurers)			
251.	Association of British Insurers	3.25.	Government bonds are also subject to credit risk – in many cases greater than that implied for swaps markets.	Noted.
252.	CEA, ECO-SLV-09-434	3.25.	Government bonds do also have credit risk. See comments to Para 3.7. Therefore this argument could also render the use of government bonds as the benchmark also inappropriate.	Noted.
253.	CRO Forum	3.25.	As swap rates do not depend on the own credit risk of an undertaking they should be seen as the basis for discounting insurance liabilities.	Not agreed. According to the Level 1 text the rates need to be risk-free.
254.	Danish Insurance Association	3.25.	In the Danish case, deriving the term structure from swap rates has been very useful. A pragmatic approach was adopted during the currency turmoil last year, when the yield of options adjusted mortgage bonds were included in the term structure. Very importantly, this helped counter severe negative procyclical effects which would have been damaging to the housing market and the broader economy (financial stability).	Not agreed. According to the Level 1 text the rates need to be risk-free.
255.	Dutch Actuarial Society – Actuariel Genootschap (	3.25.	Alternative text: Collateralised swap agreements can also be an appropriate basis for discounting technical provisions. Although swap agreements are not perfectly risk-free, they have the desirable characteristic that market prices are available for very long maturities which are relevant for discounting life insurance and pension liabilities.	Not agreed. According to the Level 1 text the rates need to be risk-free.
256.	German Insurance Association	3.25.	Government bonds do also have credit risk See comments to Para 3.7	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	- Gesamtverb and der D		Therefore this argument could also render the use of government bonds as the benchmark also inappropriate.	
257.	Legal & General Group	3.25.	Whilst swaps rates have a small degree of credit risk, a credit risk adjustment can be made and it is not reasonable to use this as a reason for excluding their use.	The text does not exclude the use of adjusted swap rates.
258.	Munich RE	3.25.	As swap rates do not depend on the own credit risk of an undertaking they should be seen as the basis for discounting insurance liabilities.	Not agreed. According to the Level 1 text the rates need to be risk-free.
259.	OAC plc	3.25.	Whilst swaps rates have a small degree of credit risk where material this can be the easily adjusted for. It therefore not reasonable to use this as a reason for excluding their use.	Not agreed. The text does not exclude the use of adjusted swap rates. We doubt that the adjustment can be made easily.
260.	Prof. Antoon Pelsser, Maastricht University	3.25.	Alternative text: Collateralised swap agreements can also be an appropriate basis for discounting technical provisions. Although swap agreements are not perfectly risk-free, they have the desirable characteristic that market prices are available for very long maturities which are relevant for discounting life insurance and pension liabilities.	Not agreed. According to the Level 1 text the rates need to be risk-free.
261.	UNESPA (Association of Spanish Insurers)	3.25.	See comments to Para 3.54	See resolution of the comments.
262.	Association of British Insurers	3.26.	We do not accept the premise that government bonds are risk free and we do not agree that the "risk free" criteria is the overwhelming criteria in determining the relevant discount rates. As set out above we see many disadvantages in the exclusive use of 'AAA' government bonds and so we do not agree with the suggested process.	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
263.	CEA, ECO-SLV-09-434	3.26.	Ceiops needs to clarify how they would expect this theoretical approach to work in practice. This approach is theoretical and the CP does not give practical solutions to demonstrate how this could work in practice and how each approach will be validated by Ceiops. This may be of particular concern for Eastern European currencies where there are no sufficiently deep or liquid government bond or swap rates and government bonds are not AAA-rated. Rather than already presenting the AAA government bond curve as the risk free interest rate, this section should present a framework for how to derive the risk-free term structure. In our opinion the framework should be made by reference to the fair value hierarchy which is endorsed by Ceiops in their advice CP 35. Thus: R The first level is a quoted price in an active market. This requires a term structure which is market observable and ready for everybody. The yield curve can be reproduced in an easy manner without the need for own calculations. The activity in the market provides a sufficient sound basis for the prices attained in the market on which the term structure is constructed. R If the market is not active e.g. not liquid the second level of the hierarchy should be used. This implies using a valuation technique which is commonly used and accepted. The inputs for this valuation technique should be market observable ensuring a level playing field. Furthermore this also implies that the technique is meeting the principles as set out by Ceiops. This valuation technique should also be used when a part of the yield curve is not liquid anymore. R Only if this valuation technique with market observable	The stree stage approach is sufficiently flexible to address these issues. Not agreed. This approach seems to be far more theoretical than the three stage approach.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			inputs does not exist or cannot be used should an insurer use own inputs. In these (remote) cases a dialogue should be started with the supervisor to get a common perspective and agreement. Furthermore the insurer should disclose the main assumptions/inputs underlying the term structure and the methodology used in deriving the term structure. In our opinion this framework should used to determine the relevant risk free interest rate term structure.	
264.	Dutch Actuarial Society – Actuariel Genootschap (	3.26.	Delete: not principle based.	Not agreed. We think the approach is principle based.
265.	German Insurance Association – Gesamtverband der D	3.26.	CEIOPS needs to clarify how they would expect this theoretical approach to work in practice This approach is theoretical and the CP does not give practical solutions to demonstrate how this could work in practice and how each approach will be validated by CEIOPS. This may be of particular concern for Eastern European currencies where there are no sufficiently deep or liquid government bond markets or swap rates and government bonds are not AAA-rated. Rather than already presenting the AAA government bond curve as the risk free interest rate, this section should present a framework for how to derive the risk-free term structure. In our opinion the framework should be made by reference to the fair value hierarchy which is endorsed by CEIOPS in their advice CP 35. Thus: R The first level is a quoted price in an active market. This	The stree stage approach is sufficiently flexible to address these issues. Not agreed. This approach seems to be far more theoretical than the three stage approach.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			requires a term structure which is market observable and ready for everybody. The yield curve can be reproduced in an easy manner without the need for own calculations. The activity in the market provides a sufficient sound basis for the prices attained in the market on which the term structure is constructed. R If the market is not active e.g. not liquid the second level of the hierarchy should be used. This implies using a valuation technique which is commonly used and accepted. The inputs for this valuation technique should be market observable ensuring a level playing field. Furthermore this also implies that the technique is meeting the principles as set out by CEIOPS. This valuation technique should also be used when a part of the yield curve is not liquid anymore. R Only if this valuation technique with market observable inputs does not exist or cannot be used should an insurer use own inputs. In these (remote) cases a dialogue should be started with the supervisor to get a common perspective and agreement. Furthermore the insurer should disclose the main assumptions/inputs underlying the term structure and the methodology used in deriving the term structure. In our opinion this framework should be used to determine the relevant risk free interest rate term structure.	
266.	Groupe Consultatif	3.26.	The Groupe believes that market stability would be better served if composite risk-free rate term structures by currency were produced regularly by taking account on a weighted basis of: All government debt denominated in own currency; Swaps of various floating leg terms having regard to market liquidity. And any other instrument which may become relevant in future.	Not agreed. Swap rates are not risk-free.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			The capacity should be retained to vary weights having regard to market developments after appropriately brief consultation. A single set of weights for the euro at any given time should suffice – weights for other currencies may differ to a usually marginal degree depending on market liquidity. In respect of the currencies with the most developed capital markets (euro and sterling) equal weight might be given to bond and swap rates at least initially. Subject to any technical differences by currency, CEIOPS or its successor body should exercise control in the interest of harmonisation.	
267.	Legal & General Group	3.26.	We fundamentally disagree with this paragraph as we do not believe that government bonds serve as the unique basis for determining the risk-free interest rate term structure. See 3.4 and other responses above. Also applies to sections 3.27 and 3.28.	Noted.
268.	OAC plc	3.26.	We fundamentally disagree with this paragraph as we do not believe that government bonds serve as the unique basis for determining the risk-free interest rate term structure. See 3.4 and other responses above.	Noted.
269.	PricewaterhouseCoopers LLP	3.26.	We welcome the three stage framework to determine the risk-free interest rate structure and the desired characteristics (3.3 to 3.21) upon which each step is judged. This comment also refers to 3.27 and 3.55.	Noted.
270.	Prof. Antoon Pelsser, Maastricht University	3.26.	Delete: not principle based.	Not agreed. We think the approach is principle based.
271.	UNESPA (Association of Spanish	3.26.	See comments to Para 3.54	See resolution of comments.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	Insurers)			
272.	Association of British Insurers	3.27.	See 3.26	See resolution of comments.
273.	CEA, ECO-SLV-09-434	3.27.	See comments to Para 3.26.	See resolution of comments.
274.	Dutch Actuarial Society – Actuariel Genootschap (	3.27.	Delete: not principle based.	Not agreed. We think the approach is principle based.
275.	German Insurance Association – Gesamtverband der D	3.27.	See comments to Para 3.26	See resolution of comments.
276.	Legal & General Group	3.27.	As per 3.26	See resolution of comments.
277.	OAC plc	3.27.	As per 3.26	See resolution of comments.
278.	PricewaterhouseCoopers LLP	3.27.	See comments under 3.26	
279.	Prof. Antoon Pelsser,	3.27.	Delete: not principle based.	Not agreed. We think the approach is principle based.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	Maastricht University			
280.	UNESPA (Association of Spanish Insurers)	3.27.	See comments to Para 3.54	See resolution of comments.
281.	CEA, ECO-SLV-09-434	3.28.	A level playing field should be ensured. In our opinion the methodology and principles chosen should be available for all relevant currencies ensuring consistency and a level playing field. Therefore, it is of vital importance that the same level of detail is provided under Level 2 for all currencies in order to ensure a level playing field is retained. CP40 currently provides different levels of guidance for the Euro relative to non-Euro currencies. It is important that this is not the case in the final version of Level 2, which should provide guidance to the same level of detail for all currencies.	Not agreed. It is neither necessary nor possible to specify the risk-free rates for all currencies at Level 2.
282.	Dutch Actuarial Society – Actuariel Genootschap (	3.28.	Reword: A process at Level 3 should ensure that the relevant risk-free interest rate term structures for the different currencies meet in the best possible way the risk-free rate criteria. The curve chosen should be explained and justified by Member States.	Noted.
283.	European Insurance CFO Forum	3.28.	Guidance to ensure that the relevant risk-free interest rate structures meet the benchmark of risk-free government rates should be provided in Level 2. CEIOPS propose that a risk-free rate term structure will be defined in Level 3 supervisory guidance. This will be received relatively late in terms of preparing for Solvency II and may result in	Not agreed. It seems not to be possible to specify the risk-free rate at level 2 as it is changing over time.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			inconsistency between different regulators. Given the significance of the issue and the importance of harmonisation across Europe, the risk-free rate term structure should be addressed in Level 2.	
284.	German Insurance Association – Gesamtverb and der D	3.28.	A level playing field should be ensured In our opinion the methodology and principles chosen should be available for all relevant currencies ensuring consistency and a level playing field. Therefore, it is of vital importance that the same level of detail is provided under Level 2 for all currencies in order to ensure a level playing field is retained. CP40 currently provides different levels of guidance for the Euro relative to non-Euro currencies. It is important that this is not the case in the final version of Level 2, which should provide guidance to the same level of detail for all currencies.	Not agreed. It is neither necessary nor possible to specify the risk-free rates for all currencies at Level 2.
285.	Groupe Consultatif	3.28.	The process has to be defined in such a way that a level playing field for the insurance companies exists and arbitrage between countries is excluded.	Noted.
286.	Institut des actuaires (France)	3.28.	We do not agree on this matter (to be read in conjunction with our comments made about paragraph 3.37.)	See resolution of comments.
287.	Legal & General Group	3.28.	As per 3.26	See resolution of comments.
288.	OAC plc	3.28.	As per 3.26	See resolution of comments.
289.	PricewaterhouseCoopers LLP	3.28.	We agree that a process at Level 3 should be implemented to ensure the risk free rate term structure for non Eurozone currencies is appropriate justified.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			This comment also refers to 3.57.	
290.	Prof. Antoon Pelsser, Maastricht University	3.28.	Reword: A process at Level 3 should ensure that the relevant risk-free interest rate term structures for the different currencies meet in the best possible way the risk-free rate criteria. The curve chosen should be explained and justified by Member States.	Noted.
291.	UNESPA (Association of Spanish Insurers)	3.28.	See comments to Para 3.54	See resolution to comments.
292.	Uniga	3.28.	We would support a clearer and more transparent definition of the derivation of the risk-free rate. A level 3 guidance for this purpose could be insufficient. We support a clear and fully harmonised definition to reduce any supervisory arbitrage. Moreover any deviation from harmonised interest rate term structures must be published and justified (Pillar 3).	Noted.
293.	CEA, ECO-SLV-09-434	3.29.	In our opinion the risk mentioned here regarding the bias is more a risk which is existing with government bonds than with the swap market. See comments to paragraph 3.13.	Noted.
294.	Dutch Actuarial Society – Actuariële Genootschap	3.29.	We believe this is a crucial point, and should be moved to before 3.22.	Noted.
295.	German Insurance	3.29.	In our opinion the risk mentioned here regarding the bias is more a risk which is existing with government bonds than with the swap	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	Association – Gesamtverb and der D		market. See comments to Para 3.13	
296.	Groupe Consultatif	3.29.	We agree with this point, which we suggest argues for flexibility from outset.	Noted.
297.	Just Retirement Limited	3.29.	Level 2 rules or Level 3 guidance should set out how “regularly” the approach to determining the risk free term structure should be “revised” (we would suggest that “reviewed” is a better term). If changes are too frequent this could introduce undue volatility into undertakings’ balance sheets and make intertemporal comparisons less meaningful.	Noted. This detail can be left to Level 3.
298.	KPMG ELLP	3.29.	We agree that the approach needs to be kept under review.	Noted.
299.	PricewaterhouseCoopers LLP	3.29.	See comments under 3.34	See resolution of comments.
300.	Prof. Antoon Pelsser, Maastricht University	3.29.	I believe this is a crucial point, and should be moved to before 3.22.	Noted.
301.	UNESPA (Association of Spanish Insurers)	3.29.	See comments to Para 3.54	See resolution of comments.
302.	AMICE	3.30.	AMICE members believe that liquidity premium should be allowed when discounting liabilities, which are illiquid by nature as non-traded on a deep market. We agree with the CEA that: - Market participants require compensation for liquidity risk on	

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
			the assets backing the liabilities; Most investors will require a premium to accept an asset (to back the liabilities) which may be hard to trade and hard to value prior to the expected maturity of the instrument. - Provided liabilities are illiquid or irredeemable and backed by illiquid assets, recognising a liquidity premium is market-consistent. - The concept of the liquidity premium is consistent with the approaches used to price and value other illiquid liabilities such as long term debt issued by companies.
303.	Association of British Insurers	3.30.	We fundamentally disagree with the majority view, which dismisses the liquidity premium without any proper consideration of the issue. There is a substantial body of academic evidence supporting the existence of the liquidity premium and it has a very substantial impact, particularly in distressed markets, on the valuation of illiquid liabilities, such as annuities. To reject this would be entirely counter to the requirement in Article 76(2) to set best estimate equal to the probability weighted average of future cashflows, using the relevant risk free interest rate term structure. This proposal would introduce a substantial layer of additional prudence, without justification and would be very damaging to the interests of millions of consumers in the UK and in other EU countries. We urgently call upon CEIOPS to reverse this decision. We agree that further work is needed to agree a harmonised application of the liquidity premium and would propose that a working group is established including representatives of CEIOPS, the industry and other experts to agree an appropriate approach.
304.	ASSOCIATION OF FRIENDLY SOCIETIES	3.30.	We believe that the illiquidity premium on some bonds has been proved to be present and is accepted as being present. For illiquid liabilities (such as annuities within the UK which allow no surrender or lapse), it would seem perverse and disproportionate to ignore all

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	(AFS)		of this research. CEIOPS should carry out a proper investigation and provide concrete reasons on why it believes that the illiquidity premium should not be allowed.	
305.			Confidential comment deleted.	
306.	AVOE – Aktuarvereinigung Österreichs – Actuarial	3.30.	In our view it should be discussed, that insurance companies can allow for an illiquidity premium. This is of significant importance to immediate life annuities where cancellation / surrender by the insured person is not an option. These future cash flows mainly depend on survivorship and won't be dependent on policyholder behaviour. When extrapolating interest rates for longer durations this should be taken into account as well.	
307.	BARRIE & HIBBERT	3.30.	This comment also applies to D.16-D.18. CEIOPS identify three sets of questions related to the application of illiquidity premia: 1) The basic principle: Should the discount rate include an illiquidity premium? 2) Measurability: How should the illiquidity premium be quantified (in a prudent, reliable and objective way)? How can the method [...] be extended [...] across different currencies, including those without government bond and swap markets? 3) Applicability: Which (re)insurance liabilities should be considered sufficiently illiquid? Consider each question in turn: The basic principle It is pretty much universally accepted that an illiquidity premium effect is evident in asset prices. See our review of the extensive	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		academic research literature on this subject "Liquidity Premium: Literature review of theoretical and empirical evidence", September 2009 (see footnoteR). This review demonstrates that liquidity effects on asset prices are evident across many different asset classes and vary significantly through time. Intermediaries who choose to hold the least-cost matching portfolio for a set of illiquid and predictable liabilities are able to capture these illiquidity premia and pass them on to savers. If insurance valuations aim to reflect this cost of replication then, in principle at least, it seems appropriate that illiquidity premia should play a part in valuation. The replicating portfolio principle is explored in the excellent IASB paper (see footnoteR). In the paper the IASB describe how a replicating portfolio of assets can be constructed that fits the characteristics of the liabilities (in terms of timing, currency and liquidity). One of the stated aims of Solvency II is that it makes optimal use of the information provided by financial markets (see footnoteR). Another of the stated aims of Solvency II is to increase the compatibility of Solvency II reporting with financial reporting, to the extent possible, so as to limit the administrative burden placed on companies (see footnoteR). We believe, for all of the above reasons, that there is a strong case for CEIOPS to give very careful further consideration to this basic valuation principle. Measurability The quantification of illiquidity premia at a specific point in time and for a specified portfolio of assets, remain contentious and create technical challenges for firms and regulators. Nevertheless, as researchers have demonstrated, it is possible to generate estimates. We do not believe that the nature of the estimation	

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate		
		challenge should be the reason for rejecting outright the use of illiquidity premia in valuation. A number of methods exist for estimation of illiquidity premia (set out in our literature review) and we believe each of the methods offers valuable information in assessing the level of illiquidity premia at a point in time. These measures might be used individually or combined together. Regulators will clearly need to evaluate them against their standards of reliability, objectively and prudence and compare this performance against the costs of removal. Applicability We acknowledge that a further practical issue concerns the circumstances in which an illiquidity premium can be used in valuing liabilities. Our view is that this should be determined by the composition of the least-cost matching portfolio. If a firm can demonstrate that cash-flows are sufficiently illiquid and predictable to hold illiquid matching assets to maturity then it seems reasonable to recognise this in valuation. We have worked with insurance firms to apply this principle across different business lines and would be willing to share this research (on the development of objective quantitative measures of liability liquidity) with CEIOPS. Summary Much additional research is likely to emerge on these topics in the coming months including our own contributions to the debate. We believe the proposed policy to exclude illiquidity premia when valuing certain (illiquid) cash flows should be reviewed because: R The existence of an illiquidity premium in asset markets is generally accepted R A replicating portfolio could choose liquidity as a

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
			characteristic to replicate and the value of the liability would reflect the liquidity premium in the replicating assets. Some allowance for illiquidity will result in a liability value that is approximately and economically correct rather than one that is almost definitely incorrect (i.e. with no illiquidity premium). There are practical solutions to the quantification of the illiquidity premium and we believe that sensible restrictions can be placed on the circumstances in which it might be used. Terminology Regarding terminology - both the terms "liquidity premium" and "illiquidity premium" are used and this can cause confusion. The fundamental point is that assets which offer trading liquidity (i.e. they are relatively cheap to buy and sell) will have higher prices than comparable assets with higher associated trading costs. This premium price is quite naturally described as a "liquidity premium". Note that if asset valuations are expressed in terms of yields, the illiquid asset will offer a higher yield than the liquid asset. This has caused some people to use the term "illiquidity premium". Although somewhat confusing, these terms are interchangeable when used in this context. The convention we follow is to refer to a liquidity premium (LP) in line with the idea that a premium price must be paid for liquid assets.
308.	CEA, ECO-SLV-09-434	3.30.	We would strongly request further investigation into this issue as the CEA believes that the "illiquidity premium" exists and should be taken into account for insurance liabilities and that its amount should be calibrated according to the degree of illiquidity of the term structure and the characteristics of the cash flows. It is important to recall that all insurance liabilities, due to their very nature, are characterised to a varying degree by a certain level of illiquidity and predictability of future cash flows. This is due

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate		
		to a number of factors such as the portfolio's actuarial characteristics (e.g. longevity risk, lapse risk), contractual characteristics (e.g. surrender options) and policyholders' behaviour within its legal and fiscal environment. This, in principle, is the case both for life and non-life activities. This influences the investment choices of insurers. Insurers will invest in assets which match the nature of their liability obligations; this includes reflecting whether or not they are likely to have to make significant unexpected asset disposals in order to meet unexpected liability cash flows. Relatively liquid assets such as cash, swap-based instruments and government bonds are needed to match relatively less predictable liability cash flows e.g. where policyholders can cash-in their policy at relatively short-notice. Other things being equal, liquid assets are more highly valued than illiquid assets as many investors (i.e. not just insurers) need liquidity to match their liability outgoes. Expected returns on relatively illiquid assets therefore can be expected to be higher than those on otherwise equivalent liquid assets. This provides insurers, depending on the degree of predictability and stability of future liability cash flows, with the opportunity to realise the higher returns available on less liquid assets such as corporate bonds and so to achieve an "illiquidity premium". In other words, the nature of their liability cash flows is such that investing in less liquid cash flows does not expose them to the significant ALM and liquidity risks that would apply for less predictable liability cash flows, so they have significantly less need for liquid assets. As a consequence, the CEA believes that the "illiquidity premium" exists and should be taken into account for insurance liabilities and that its amount should be calibrated according to the degree of illiquidity of the term structure and the characteristics of the cash flows. This could be done by defining an appropriate function to be

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
			applied in a harmonised way to all insurance liabilities, undertakings and countries. As an example, we would expect that classes of business having a shorter duration (taking into account the characteristics of the class of business) would attract a very low illiquidity premium if any, whilst those classes of business having a longer duration would attract an enhanced illiquidity premium. This approach should ensure a level playing field across the EU and between insurance products. Ceiops states in CP40 that the majority of its members do not believe that the risk-free interest rate term structure should include an illiquidity premium. We strongly disagree with this statement and support the views of the minority of Ceiops members who believe that this area needs further investigation and, on the basis that a liquidity premium exists, a practical approach to its quantification and application. The ability to realise such "illiquidity premiums" is an important, well accepted and valued feature of insurance liabilities that have stable and predictable cash flows. It needs to be reflected in the transfer value approach used under Solvency II and as such the correct calibration of the risk-free discount rate will include this "illiquidity premium". Further work is needed to develop its application.
309.	CRO Forum	3.30.	We advocate to use the swap curve as risk free rate; an illiquidity premium adjustment to these rates should be taken into account, as expressed in our letter issued in June. The risk that this illiquidity spread widens does not necessarily mean that policyholders are put at increasing risk due to the often illiquid nature of the liabilities and the fact that an (re)insurance company may not be a forced seller of assets. The inclusion of a liquidity premium should: • Encourage good ALM practices for illiquid liabilities

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			- Limit pro-cyclicality by responding to changes in markets - Ensure consistency across Europe and with other risk based regimes The CRO Forum, in parallel with the CFO Forum, is currently working on this topic to provide concrete recommendations (not before October) on ways to measure Liquidity Premium and to apply it on the liabilities.	
310.	Danish Insurance Association	3.30.	The issue of an illiquidity premium cannot be seen in isolation from the criteria for a term structure which CEIOPS stipulates. If a term structure can deliver a sound mix of the many criteria CEIOPS deems important, it makes sense to allow for an illiquidity premium.	
311.	DIMA (Dublin International Insurance & Management)	3.30.	We support a risk free rate based on SWAPS with some allowances for illiquidity premium.	
312.	Dutch Actuarial Society – Actuariële Genootschap	3.30.	We strongly agree with this point!	
313.	European Insurance CFO Forum	3.30.	The CFO Forum disagrees with the view that no allowance should be made for illiquidity premium. Currently, no allowance is made for illiquidity despite the fact that many views acknowledge that illiquidity premium exist. The illiquidity premium has become more relevant as it has markedly increased	

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
			since the widening of spreads during the financial crisis. Solvency II proposals are inconsistent with IFRS Phase II proposals which have suggested a discount rate consistent with the characteristics of the liabilities. Consistency of the discount rate with IFRS Phase II is desirable to the extent that IFRS principles are consistent with sound economic principles. This type of consistency reduces reconciliation differences and the CFO Forum consider the draft IFRS Phase II principles in the Discussion Paper to better reflect the economics of insurance liabilities. The CFO Forum MCEV Workgroup is currently running a project to determine how illiquidity premia could be quantified and to which products it would apply and consistency with this work stream is also desirable as the MCEV framework is also based on economic principles. In addition, the replicating portfolio techniques outlined in CP41 implicitly include an allowance for illiquidity premia.
314.	Federation of European Accountants (FEE)	3.30.	Under normal circumstances, most bonds traded in active markets have full liquidity, i.e. can be sold at any time. The cash flows that are considered in actuarial models are fully fixed regarding timing, since any possibility of premature payment is already considered in the probabilities associating payments to periods. As a consequence, the observed interest rates on AAA-government bonds need to be adjusted for illiquidity to match the cash flows to be discounted. If the uncertainty of the timing of cash flows, especially caused by policyholders' behaviour in case of discontinuation options, is reflected by estimated probabilities and made risk-free by specific risk margins for the deviation risk inherent in the estimated probabilities, the resulting cash flows scenarios are entirely deterministic and illiquid.
315.	FFSA	3.30.	FFSA noted that CEIOPS is, in majority against the illiquidity

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		premium. FFSA disagrees with this approach which appears to be excessively conservative as there seems to be a wide consensus amongst experts that illiquidity premium exists (as illustrated by the widening of spreads during the financial crisis). In addition, including an illiquidity premium would ensure consistency with other practises (IFRS, MCEV principles). Calculation of such illiquidity premium should be provided with the same method for all currencies and at the same level regardless of the liquidity of liabilities in order to ensure consistency among undertakings and avoid market distortions. The rationale for applying the same adjustment to all undertakings without distinction of liabilities liquidity can be found in the way best estimates and risk margin are calculated, taking already into account the volatility of underwriting risk such as lapses, mortality, time value of options and guarantees, etc. In addition, SCR calculations also cover the risk of deviation of those parameters Also, any manichean solution where certain contracts would be valued with an illiquidity premium and others without an illiquidity premium would lead to unjustified distortions between contracts which level of illiquidity is very close. Indeed, at portfolio level and on an economic basis, total illiquidity does not exist except for capitalization contracts that can not be surrendered. The uncertainty on future cash flows depends on the portfolio's actuarial characteristics (ex: Longevity risk), contractual characteristics (e.g. surrender option) and policyholders behavior (rational behavior of the policyholders). In addition, referring to the level of illiquidity embedded in liabilities would imply different liquidity premiums, hence different risk free rates which seems too complex and burdensome to implement Consequently, FFSA is in favour of one relevant risk free curve to	

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			be applied for all products regardless of the investment strategy adopted and the nature of the liabilities. This relevant risk free curve could be the AA corporate bond yield curve minus an adjustment for credit risk that could be approximated by the swap curve plus an illiquidity premium in case of illiquid market as at end of 2008.	
316.	German Insurance Association – Gesamtverb and der D	3.30.	We would strongly request further investigation into this issue as the GDV believes that the “illiquidity premium” should be taken into account.	
317.	GROUPAMA	3.30.	Furthermore, we would like to emphasize the need to use upwards adjustment in certain market conditions : - As the Directive states, the risk free rate should be free for default risk, but not for liquidity risk. At the end of 2008, market values of corporate bonds included an illiquidity premium, a risk that is managed on pillar II and is usually not material for insurers following a Buy & Hold strategy. An upward adjustment of the illiquidity spread on the risk free rate appeared to be a good way of correcting it. Due to the financial crisis, the market value of some non AAA-rated government bonds went down. This decline would not have any impact on future results of the company following a Buy & Hold strategy unless the government went bankrupt. However, using a market-consistent approach and a risk free rate without an adjustment would lead to a substantial decline in eligible elements, even if the Government did not go bankrupt. If this issue is not taken into account using an upward adjustment, insurers could avoid non AAA-rated government bonds in order to minimise the	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
			volatility of their solvency statement. This could have macro-economic impacts on non AAA-rated Government ability to raise debt.
318.	Groupe Consultatif	3.30.	Substantial elements of life insurer liabilities cannot be affected in their timing by voluntary policyholder behaviour. This confers an advantage on such insurers as investors in that they can earn and pass on to policyholders the compensation which other investors with liquid liabilities require for the timing risk associated with such liabilities. This 'illiquidity premium' which is a function of different behaviours of distinct investor clienteles is well supported by objective studies and has been very substantial during much of the last year. Research suggests that the illiquidity premium reflects two factors – market liquidity (in respect of which the premium is compensation for actual and potential bid-offer spreads and associated trading costs) and clientele effects (the different behaviours of investors funded with liquid and illiquid liabilities respectively, attributing a yield premium to the latter). These two factors tend to be correlated both from time to time and in accordance with the level of riskiness of the asset class. The clientele effect is the more variable. There is a consensus that the illiquidity premium varies over time and tends to be higher in absolute terms (although not necessarily as a proportion of total spread) for riskier asset classes. It tends not to increase with asset duration. Groupe Consultatif is aware of extensive research directed at quantifying the illiquidity premium associated with various asset classes before and during the recent crisis. A fair summary might be that the premium in respect of higher quality investment grade classes is normally modest but can become very substantial in for example a context of deleveraging such as prevailed in late 2008. Many theoretical quantification methods are quite sensitive to input

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			assumptions. Nevertheless the Groupe believes that in the interest of realising Solvency 2 as a robust framework, it should be possible to draw on research to develop and refine robust practical algorithms for the treatment of liabilities the timing of which is not affected by voluntary policyholder behaviours. Such algorithms should address both discount rates and SCR requirements in respect of spread risk.	
319.	Institut des actuaires (France)	3.30.	This matter should be investigated by the special task force (see general comments).	
320.	Investment & Life Assurance Group (ILAG)	3.30.	We believe that the illiquidity premium on some bonds has been proved to be present and is accepted as being present. For illiquid liabilities (such as annuities within the UK which allow no surrender or lapse), it would seem perverse and disproportionate to ignore all of this research. CEIOPS should carry out a proper investigation and provide concrete reasons on why it believes that the illiquidity premium should not be allowed.	
321.	Just Retirement Limited	3.30.	We disagree fundamentally with this conclusion. Observable market data, as well as historical evidence, show that financial and insurance markets demand additional compensation (an "illiquidity premium") for holding potentially illiquid assets. This is not compensation for credit risk, and so does not conflict with 3.3(a) ("no credit risk"). Disregarding this evidence would be contrary to Article 75 paragraph 3, which states that "The calculation of technical provisions shall make use of and be consistent with information provided by the financial markets". It is clearly important for Solvency II and IFRS to be consistent with each other as far as possible. The IASB discussion document on insurance liabilities (Phase 2) recognised liquidity as one of the aspects that need to be taken into account in determining the term	

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate		
		structure used to discount cash flows: “the objective of the discount rate is to adjust estimated future cash flows for the time value of money in a way that captures the characteristics of the liability, not the characteristics of the assets viewed as backing those liabilities. Therefore the discount rate should be consistent with observable current market prices for cash flows whose characteristics match those of the insurance liability, in terms of, for example, timing currency and liquidity.” As well as the theoretical arguments in support of an illiquidity premium, there are strong practical considerations: R In member states such as the UK where an illiquidity premium is permitted in appropriate cases, de-recognising it would have caused very significant disruption to undertakings’ balance sheets when markets became illiquid in the credit crisis. It is likely that this would have led to a vicious spiral of forced asset sales, value destruction and systemic risk, at a time when governments around the globe were taking unprecedented actions to contain the impact of the credit crisis on the banking sector. Examples of the phenomena to be avoided are well described in Appendix A. R Furthermore, an illiquidity premium allows insurers to exploit synergies between illiquid liabilities and market compensation for illiquidity, which in turn supports benefits payable to policyholders, both directly and in relation to competitive forces. The fact that insurers have been confident enough, for a number of years, to enhance policyholder benefits as a direct result of the existence of the illiquidity premium provides powerful evidence that such a premium exists. Not recognising the illiquidity premium, and hence penalising companies for investing in such assets, would therefore have a direct impact on the level of benefits payable to future

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
			policyholders, with no apparent compensation via improved security of benefits. R Significant public/social policy consequences are likely to arise from this proposed change, via the impact on the level of benefits payable under the retirement products (such as annuities) in a number of Member States. R The “built-in demand” for potentially illiquid assets, such as corporate bonds, which is a consequence of the current treatment, has provided valuable support for issuers during the credit crisis. Not recognising the illiquidity premium would therefore reduce significantly the demand for such assets, thereby harming the issuers of these instruments. Were the reduction in demand for corporate bonds not made up from elsewhere, companies would be forced to tap equity markets for finance instead, with the likely impact of exerting downward pressure on equity prices. These observations provide compelling support for the existence and practical benefits of allowing an illiquidity premium, and therefore where an entity holds liabilities of a suitably illiquid nature appropriate allowance should be made for the impact of such a premium. For reasons of harmonisation this could be done by requiring firms to identify the impact of the illiquidity premium under a new category of asset or liability, rather than by adjusting the risk-free rate itself.
322.	Legal & General Group	3.30.	By ignoring the nature of the liabilities and not recognising illiquidity premium in appropriate circumstances the proposals create a system with inherently high systematic risk and pro-cyclicality features that is not robust to market distortions such as the recent economic turbulence.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
323.	Lucida plc	3.30.	We believe that it would be appropriate to allow for an illiquidity premium since without this adjustment the resulting technical provisions would exceed the "current amount insurance undertakings would have to pay if they were to transfer their obligations to another insurance undertaking".	
324.	Munich RE	3.30.	We advocate to use the swap curve as risk free rate; a liquidity premium should be taken into account over the swap rate where appropriate. CRO and CFO Forum both set up working groups to deal with the liquidity premium issue. The outcome of these working groups will provide further input for this issue.	
325.	OAC plc	3.30.	By ignoring the nature of the liabilities and not recognising illiquidity premium in appropriate circumstances the proposals create a system with inherently high systematic risk and pro-cyclicality features that is not robust to market distortions such as the recent economic turbulence.	
326.	Pacific Life Re	3.30.	The text suggests that no credit should be given for any "illiquidity premium" and that the great majority of CEOIPS support this view. We disagree and consider that companies should be allowed to take credit for the illiquidity premium, subject to appropriate controls.	
327.	PEARL GROUP LIMITED	3.30.	We are surprised, and concerned, that CEIOPS intends not to allow the illiquidity premium when CEIOPS recognises the benefit of liquidity within assets but will not recognise the benefit of having illiquid liabilities. We disagree with CEIOPS on this.	
328.	PricewaterhouseCoopers LLP	3.30.	Illiquidity premium Characteristics of liabilities in the valuation of technical provisions In the valuation of technical provisions, the Level 1 text refers to: "the amount ... to transfer their ... obligations immediately to	

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate		
		another ... undertaking" (Article 75(2)) and "the amount ... in order to take over and meet ... obligations" (Article 76(3)). This is further elaborated on in Recital (32): "The amount of technical provisions should reflect the characteristics of the underlying insurance portfolio." The characteristics of liabilities are therefore an important factor in the valuation of technical provisions. The characteristics of the liabilities would include, for example, their term, currency and liquidity. Term and currency are captured though the use of a term structure for the discount rate in the relevant currency that the liability is denominated. By the liquidity characteristic of liabilities, we are referring to the ability of the policyholder to exit their policy early with a cash payment (e.g. surrender or lapse), for example, a unit linked policy without a surrender penalty would be considered highly liquid as a policyholder can readily convert their investment to cash without penalty. Conversely, liabilities such as UK annuities, defined to have a fixed regular income until death with no surrender value, would possess illiquid characteristics. In addition, there are likely to be products with various degrees of illiquidity, for example unit linked policies with surrender penalties. We do not believe a single liquid risk free term structure for each currency captures the characteristics of liabilities as required by the Level 1 text. Does an "illiquidity premium" exist in asset prices? An "illiquidity premium" is the extra return that the market might require (over a "liquid" risk-free rate) for a risk-free (that is free from credit risk), illiquid investment. There have been numerous studies of this matter, primarily in relation to corporate bond markets, including: R Analyses of corporate bond yields;

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		R Credit default swap spreads; R Model-based approaches (e.g. regular decomposition of corporate bond spreads by UK Bank of England, Longstaff's comparison of US Treasury and Refcorp bonds etc.); and R Many others academic studies. The studies are primarily focused on the major currencies (US dollar, Euros, UK pound sterling). Although these may produce different answers at different times, due to the assumptions, available data and approximations made there is consensus (irrespective of the time period studied) that an illiquidity premium exists in a range of capital markets and specifically corporate bonds markets. Further, the magnitude of the illiquidity premium changes over time and was higher in the last quarter of 2008 and in 2009 than it has often been in the past. In "normal" time, the premium is relatively modest. This is to be expected as investors will require some compensation for the risk that they will not be able to readily realise their investment. In times of high liquidity in the market, any illiquidity premium is likely to be small; currently, with low liquidity in the market, it is likely to have risen. The default assumption is that an illiquidity premium does exist in certain asset classes and specifically in corporate bond markets. Illiquidity premium in the valuation of technical provisions To meet the Level 1 text requirements, the liquidity characteristic of the liabilities should be reflected in the valuation of technical provisions. This is often expressed (as noted in this paragraph) as an "illiquidity premium" applied to the liquid risk free term structure for certain liabilities which have illiquid characteristics. We concur with D17 that there is no current best practice to	

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate		
		determine the illiquidity premium. However, it is hard, based on the body of evidence from the financial markets (as noted above), to conclude that the answer is zero by default. We recommend that further research is commissioned to define the liquidity characteristic of liabilities and identify robust methods of estimating the illiquidity premium. It is important that the approach adopted ensures consistency across the insurance industry. This can then be reflected in Level 2 and Level 3 text as appropriate. For example, Level 2 text could include a definition of the liquidity characteristic of liabilities together with high level principles as to the method of quantifying the illiquidity premium. Further detailed guidance in Level 3 text with full disclosure and independent scrutiny would be important to ensure consistency and greatest harmonisation. We would be happy to participate in further CEIOPS consultation on this important matter. Other considerations We would also like to draw three other considerations to your attention: R The current views of the UK regulatory authority as expressed by Adair Turner (Chairman of the UK FSA) to the Association of British Insurers (9 June 2009): "One important area is the treatment of the annuity business, where the UK is somewhat of an outlier in the extent of private annuity provision and where that provision could become more important as defined benefit pensions continue to decline and defined contribution pensions requiring annuitisation grow in importance. A prudent approach to annuity capital requirements,

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			with adequate recognition of the probability of bond default, is clearly important, but it is also important to recognise that the annuity business in particular is different from the business of banking, not subject to liquidity risk, and specifically focused on matching long-term liabilities with long-term assets. The new Solvency II capital regime therefore needs explicitly to recognise that there is an illiquidity premium in bond yields, while making sure that we do not overstate that illiquidity premium and understate probabilities of default.” R We understand that the IASB is considering whether an allowance for an illiquidity premium should be made in the IFRS Phase II standards. Though this maybe a different conceptual framework, consistency with this developing standard should be a consideration. We refer to the IASB staff paper tabled at the Insurance Working Group in November 2008 which gives initial consideration to this matter. R In certain markets, the exclusion of an illiquidity premium is likely to result in significant policyholder detriment through additional unnecessary cost in purchasing certain contracts, for example, UK annuity contracts. This comment refers to D.17 and D.18.	
329.	RBS Insurance	3.30.	An allowance for an increase to the risk free rate to reflect an illiquidity premium would result in lower discounted reserves and this could be viewed as being less prudent. This would be of greater importance in life assurance than non-life insurance.	
330.	ROAM – Draft V2	3.30.	ROAM members believe that a liquidity premium should be allowed when discounting liabilities, illiquid by nature as non-traded on a deep market. Key reasons may be the following: - Market participants require compensation for liquidity risk on	

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			the assets backing the liabilities; most investors will require a premium to accept an asset (to back the liabilities) which may be hard to trade and hard to value prior to the expected maturity of the instrument. - Provided liabilities are illiquid or irredeemable and backed by illiquid assets, recognising a liquidity premium is market-consistent. - The concept of the liquidity premium is consistent with the approaches used to price and value other illiquid liabilities such as long term debt issued by companies.	
331.	The Equitable Life Assurance Society (UK)	3.30.	Our understanding is that best-estimate technical provisions are intended to represent the value at which liabilities would be transferred between undertakings (before adjustment for the cost of capital) In the case of UK annuity business it is generally accepted that such liabilities would be backed to a large extent by a portfolio of corporate bonds. The terms for the transfer of an annuity portfolio would in practice recognise the inherent "illiquidity premium". This has been demonstrated in recent transactions. In particular, when the Equitable transferred the majority of its non-profit annuity book to Canada Life. Therefore, in our view, and based on our experience, the use of risk-free rates would overstate the market value of annuity liabilities.	
332.	UNESPA (Association of Spanish Insurers)	3.30.	CEIOPS states in CP40 that the majority of its members do not believe that the risk-free interest rate term structure should include an illiquidity premium. However, a minority of CEIOPS members believe that this area needs further investigation. We would strongly request further investigation into this issue as UNESPA believes that the "illiquidity premium" should be taken into account.	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		An “illiquidity premium” should be taken into account in the discount rate for insurance liabilities and that its amount should be calibrated according to the degree of illiquidity of the related cash flows Insurers will invest in assets which match the nature of their liability obligations; this includes reflecting whether or not they are likely to have to make significant unexpected asset disposals in order to meet unexpected liability cash flows. Relatively liquid assets such as cash, swap-based instruments and government bonds are needed to match relatively less predictable liability cash flows, e.g. where policyholders can cash-in their policy at relatively short-notice. Other things being equal, liquid assets are more highly valued than illiquid assets as many investors (i.e. not just insurers) need liquidity to match their liability outgoes. Expected returns on relatively illiquid assets therefore tend to be higher than those on otherwise equivalent liquid assets. This provides insurers, depending on the degree of predictability and stability of future liability cash flows, with the opportunity to realise the higher returns available on less liquid assets such as corporate bonds and so to achieve an “illiquidity premium”. In other words, the nature of their liability cash flows is such that investing in less liquid cash flows does not expose them to the significant ALM and liquidity risks that would apply for less predictable liability cash flows, i.e. they have significantly less need for liquid assets. The present value of an illiquid liability should be, in absolute terms, lower than the present value of a liquid liability The reason is obvious; It can be obtained a higher profit out of the funds coming from illiquid liabilities than out of the funds coming from liquid liabilities. This concept should be extended to liabilities	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		in which the insurance company will no suffer from the market fluctuations of the invested assets in case of early surrender or policies with high penalties in case of early surrender. In fact the slope of the rates curve is built based on the expected evolution of interest rates and this concept. We could also observe that in the investment products available in the market. Under normal market conditions of the short end of the curve, a 1-year bank deposit gives a higher return than the money left in the current account, or than a deposit in a 3, 6 or 9 months maturity. If we analyze it from an investment point of view , it can not be paid a high rate for the money lend in 1 day maturity, as it can not be obtained any profit out of it (but the EONIA) . Therefore, the liability associated to that is worth a little in relative terms. If the funds are lent in 1 year maturity, the rate of return should be higher as before, as it could be gotten a higher return out of the lendend funds. If the maturity of the loan is 10 years maturity, the rate of return should be even higher as the entity that is taken the funds would have a higher period to make profitable the investment coming out of this funds. This reasoning is the financial logic underlying the ALM. It is accepted in the market that illiquid bonds pay a higher yield than liquid bonds. The consideration of the liability as illiquid will allow the insurance company to invest in illiquid bonds, which, as previously mentioned will give the insurance company a higher return. The possibility of invested in illiquid assets, materialized or not, is an option that in our opinion has a value, that we think it is not reflected in any way in the SCR model calculation. Therefore, we would propose the inclusion of this option as a spread over the selected risk free rate in the liability valuation.	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
			The justification of the inclusion of the illiquidity premium over the risk free rate in stead of over the liability flows comes from the fact that doing so, it could be distorted the company's ALM. In order to quantify the illiquidity premium, we would propose the application of a correction over the "risk-free rate" obtained from "historical default data". This procedure was applied in United Kingdom. We understand that as previous step over the inclusion of this corrected factor, the products should be categorized. We would recommend the use of the next principles for the implementation: - The beneficiary can not decide on product liquidity. The investments of the insurance company will be done taking into account this feature. - The product is liquid, but the surrender value is linked to the market value. Doing so, and due to the current market conditions, the surrender would mean a significant decrease of the policyholder expected return. - The product is liquid, but have a choice of security (capital or type) that is much higher than market conditions. Therefore, illiquidity premium should be extended to all the liabilities in which it does not exist a surrender value at all, to the liabilities in which the market risk of the invested assets in the case of surrender will not be suffered by the insurance company, or to policies with high penalties in case of anticipated surrender.
333.	XL Capital Ltd	3.30.	We urge CEIOPS to investigate the issue of liquidity premium further. We believe that an allowance for the liquidity premium should be permitted within the discount rate for annuity liabilities. We believe that the increase in liabilities from excluding this premium will be prohibitively high for the UK annuity industry.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
334.	Association of British Insurers	3.31.	See 3.26	See resolution of these comments.
335.	CEA, ECO-SLV-09-434	3.31.	In this section Ceiops already assumes that this term structure is risk free because it is based on AAA government bonds. However as the Iceland case have shown the assumption of having no credit risk is not fully correct. We also question what would happen to this rate if one (of the bigger) contributing parties to the ECB curve would be downgraded. This would have serious effect on the discount rate and will present a trend breach with its corresponding effects on the valuation of the technical provision.	Noted. If further analysis shows that AAA rated government bonds include a significant credit spread a downward adjustment should be made under the three stage approach.
336.	CRO Forum	3.31.	With respect to the 4th bullet point we want to point out that in periods of financial distress this spread can be higher, e.g. 20bps.	Noted.
337.	Dutch Actuarial Society – Actuariel Genootschap (	3.31.	Change to principle based! For example: Given the current market circumstances, CEIOPS recognises that there is currently no single best curve that satisfies all the risk-free rate criteria. In a “comply or explain” procedure, CEIOPS endorses the ECB-AAA curve for euro. However, supervisors may choose to the risk-free term structure to be approximated by means of other instruments which are most in line with the risk-free rate criteria. In the remainder of the section give a more balanced overview of pro’s and con’s of ECB-AAA curve versus other possible curves, e.q. swap-curve.	Not agreed. As all undertakings operate on the same financial market it is not appropriate to allow for differing risk-free rates.
338.	German Insurance Association –	3.31.	26. In this section CEIOPS already assumes that this term structure is risk free because it is based on AAA government bonds. However as the Iceland case have shown the assumption of having no credit risk is not fully correct.	Noted. If further analysis shows that AAA rated government bonds include a significant credit spread a downward adjustment should

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	Gesamtverb and der D		We also question what would happen to this rate if one (of the bigger) contributing parties to the ECB curve would be downgraded. This would have serious effect on the discount rate and will present a trend breach with its corresponding effects on the valuation of the technical provision.	be made under the three stage approach.
339.	Groupe Consultatif	3.31.	The approach of the ECB can be used to derive a criterion for market turbulence, when market consistent valuations at the valuation date do not exist.	Noted.
340.	Institut des actuaires (France)	3.31.	The coherence of euro curves should not be neglected (to be read in conjunction with our comments made about paragraph 3.37.)	Noted.
341.	PricewaterhouseCoopers LLP	3.31.	See comments under 3.34	See resolution of these comments.
342.	Prof. Antoon Pelsser, Maastricht University	3.31.	Change thw whole section 3.1.4 to principle based. For example use an introduction like: Given the current market circumstances, CEIOPS recognises that there is currently no single best curve that satisfies all the risk-free rate criteria. In a "comply or explain" procedure, CEIOPS endorses the ECB-AAA curve for euro. However, supervisors may choose to the risk-free term structure to be approximated by means of other instruments which are most in line with the risk-free rate criteria. In the remainder of the section give a more balanced overview of pro's and con's of ECB-AAA curve versus other possible curves, e.q. swap-curve. For example: A strong argument in favour of the ECB-AAA curve is the fact that	Not agreed. As all undertakings operate on the same financial market it is not appropriate to allow for differing risk-free rates.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			is (very close to) risk-free. Although liquidity in normal market circumstances is sufficiently large, the market liquidity in times of stress remains largely untested. A disadvantage of the ECB-AAA curve is the lack of market-prices for maturities larger than 30 years. Although swap agreements are not perfectly risk-free, they have the desirable characteristic that market prices are available for very long maturities which are relevant for discounting life insurance and pension liabilities. Furthermore, during the peak of the financial crisis (end 2008) the liquidity in the swap-market was sufficient to meet the hedging demands of very large parties in the market. Even though supply/demand imbalances lead to a noticeable decline in long-dates swap-rates (which indicates that the liquidity of the swap-market is not unlimited), the swap-market remained operational during this extremely stressful period.	
343.	Dutch Actuarial Society – Actuariële Genootschap (	3.32.	See above	See resolutions above.
344.	Groupe Consultatif	3.32.	We believe the Svensson model may bear some detailed consideration as to its appropriateness for this particular purpose.	Noted.
345.	PricewaterhouseCoopers LLP	3.32.	See comments under 3.34	See resolutions to comments.
346.	Prof. Antoon Pelsser, Maastricht University	3.32.	See above	See resolutions above.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
347.	Association of British Insurers	3.33.	See 3.26 and general comments	See resolutions to comments.
348.	CEA, ECO-SLV-09-434	3.33.	The market for longer maturities is not big enough for all insurers and pension funds to be able to earn the rates in practice. The AAA government bond market is not big enough to meet all the possible demands from insurers and pension funds especially for the longer maturities (20 years and longer; see market amounts as presented in www.ibox.com)). The market for swaps is bigger and has the potential to expand when the demand increases.	Noted.
349.	Dutch Actuarial Society – Actuariële Genootschap (	3.33.	See above	See resolutions above.
350.	German Insurance Association – Gesamtverband der D	3.33.	The market for longer maturities is not big enough for all insurers and pension funds to be able to earn the rates in practice The AAA government bond market is not big enough to meet all the possible demands from insurers and pension funds especially for the longer maturities (20 years and longer; see market amounts as presented in www.ibox.com)). The market for swaps is bigger and has the potential to expand when the demand increases.	Noted.
351.	Institut des actuaires (France)	3.33.	Read our comments made about paragraph 3.31	See resolutions to comments.
352.	PricewaterhouseCoopers	3.33.	See comments under 3.34	See resolution to comments.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	LLP			
353.	Prof. Antoon Pelsser, Maastricht University	3.33.	See above	See resolutions above.
354.	RBS Insurance	3.33.	More detail is required on what would happen should a member state's credit rating not be 'AAA', and arrangements should a state's credit rating change.	Noted. Stage 2 or three of the three stage approach apply.
355.	Association of British Insurers	3.34.	See 3.26 and general comments	See resolutions above.
356.	CEA, ECO-SLV-09-434	3.34.	It is of vital importance that the same level of detail is provided under Level 2 for all currencies in order to ensure a level playing field is retained. Ceiops indicates that a uniform methodology is expected to be followed for a given currency, but it is not clear at this stage how consistency will then apply among currencies. This CP defines the risk-free rate term structure for the Euro to some detail, but the definition of the relevant risk-free rate term structure for other currencies is postponed at level 3 (3.37). We completely disagree with Ceiops' approach (3.34 & 3.37) and consider that to avoid market distortions and ensure consistency Ceiops should set the same level of detail for all currencies at Level 2.	Not agreed. It is neither necessary nor possible to specify the risk-free rates for all currencies at Level 2.
357.	Dutch Actuarial Society – Actuariële Genootscha	3.34.	See above	See resolutions above.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	p (			
358.	FFSA	3.34.	See 3.48	
359.	German Insurance Association – Gesamtverb and der D	3.34.	It is of vital importance that the same level of detail is provided under Level 2 for all currencies in order to ensure a level playing field is retained CEIOPS indicates that a uniform methodology is expected to be followed for a given currency, but it is not clear at this stage how consistency will then apply among currencies. This CP defines the risk-free rate term structure for the Euro to some detail, but the definition of the relevant risk-free rate term structure for other currencies is postponed at level 3 (Para 3.37). We completely disagree with CEIOPS’ approach (Para 3.34 and 3.37) and consider that to avoid market distortions and ensure consistency CEIOPS should set the same level of detail for all currencies at Level 2.	Not agreed. It is neither necessary nor possible to specify the risk-free rates for all currencies at Level 2.
360.	Groupe Consultatif	3.34.	The valuation of assets and hedging instruments which replicate or match the liability cash flows depends on swap rates. There is an argument that the valuation of liabilities should also be based on swap rates to ensure consistency in the valuation. We do not agree that the government bond term structure constructed by the ECB satisfies all the risk free criteria. There is inherent basis risk between the ECB risk free curve and the constituent government bond used between different dates for the construction of the risk free curve. There is therefore a high level of inherent technical biases under normal economic conditions and an amplified level of technical bias at times of economic stress. This technical bias creates pro-cyclicality For example, prior to a AAA government bond being downgraded it can satisfy all the criteria to be included in the ECB AAA yield curve,	Not agreed. The hedging instruments are not valued on a risk-free basis.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			however, those bonds will trade at a higher yield. However, immediately on downgrade it will be excluded, therefore, other things being equal the ECB AAA yield curve will fall, and liabilities rise with no change in asset values.	
361.	Legal & General Group	3.34.	We do not agree that the government bond term structure constructed by the ECB satisfies all the risk free criteria. There is inherent basis risk between the ECB risk free curve and the constituent government bonds. For example, prior to a AAA government bond being downgraded it can satisfy all the criteria to be included in the ECB AAA yield curve, but, those bonds will trade at a higher yield. However, immediately on downgrade it will be excluded, therefore, other things being equal the ECB AAA yield curve will fall, and liabilities rise with no change in asset values. At the same time no insurers would have held capital for this basis risk.	Not agreed. The notion and relevance of basis risk is unclear in this context.
362.	OAC plc	3.34.	We do not agree that the government bond term structure constructed by the ECB satisfies all the risk free criteria. There is inherent basis risk between the ECB risk free curve and the constituent government bond used between different dates for the construction of the risk free curve. There is therefore a high level of inherent technical biases under normal economic conditions and an amplified level of technical bias at times of economic stress. This technical bias creates pro-cyclicality	Not agreed. The notion and relevance of basis risk is unclear in this context.
363.	PricewaterhouseCoopers LLP	3.34.	Risk free interest rate for Eurozone The risk free interest rate for the Eurozone is defined as the European Central Bank “AAA” rated government bond yield curve. We believe this should not be defined in Level 2 text which will be a binding European Union regulation. A definition in Level 2 text may not be sufficiently flexible to allow for changes in future	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			circumstances. Paragraph 3.29 notes a requirement for regular review due to potential changes in circumstances; however, it is not clear how this would be achieved in Level 2 text. This comment also refers to 3.29, 3.31-3, 3.50 and 3.58.	
364.	Prof. Antoon Pelsser, Maastricht University	3.34.	See above	See resolutions above.
365.	ROAM – Draft V2	3.34.	See 3.48	See resolutions there.
366.	CEA, ECO-SLV-09-434	3.35.	Ceiops already acknowledges that the approach (stage 1) taken by them is not realisable for all markets within the European Union and outside the European Union. This will provide the industry with means for regulatory arbitrage. The swap rate as benchmark would limit this possibility for regulatory arbitrage.	Not agreed. Swaps are not risk-free.
367.	CRO Forum	3.35.	We also suggest the use of swap rates plus a liquidity premium as risk free rate for other countries to create a level playing field.	Not agreed. Swaps are not risk-free.
368.	Dutch Actuarial Society – Actuariel Genootschap (	3.35.	Change to principle based. Then we don't need to make the distinction between euro and other currencies.	Noted.
369.	German Insurance Association –	3.35.	CEIOPS already acknowledges that the approach (stage 1) taken by them is not realisable for all markets within the European Union and outside the European Union. This will provide the industry with means for regulatory arbitrage. The swap rate as benchmark would	Not agreed. Swaps are not risk-free.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	Gesamtverb and der D		limit this possibility for regulatory arbitrage.	
370.	Groupe Consultatif	3.35.	Using the ECB criteria for deciding whether to include government bonds, in particular the actively traded requirement with a maximum bid-ask spread would create basis risk for almost all countries as bonds irrespective of their issue size could be excluded between different days yield curves creating a movement in liabilities with no associated change in asset values, thereby leading to pro-cyclical effects. Long dated government debt is more likely to fall outside the ECB criteria across different days so could result in switching between methodologies for setting long-term interest rates which would further increase the basis risk.	Not agreed. The notion and relevance of basis risk is unclear in this context.
371.	Legal & General Group	3.35.	Using the ECB criteria for deciding whether to include government bonds, in particular the actively traded requirement with a maximum bid-ask spread would create basis risk for almost all countries. This is because bonds irrespective of their issue size could be excluded between different days yield curves creating a movement in liabilities with no associated change in asset values, thereby leading to pro-cyclical effects. These issues are amplified on 31 December when markets are traditionally less liquid. Long dated government debt is more likely to fall outside the ECB criteria across different days so could result in switching between methodologies for setting long-term interest rates which would further increase the basis risk.	Not agreed. The notion and relevance of basis risk is unclear in this context.
372.	OAC plc	3.35.	Using the ECB criteria for deciding whether to include government bonds, in particular the actively traded requirement with a maximum bid-ask spread would create basis risk for almost all countries as bonds irrespective of their issue size could be excluded	Not agreed. The notion and relevance of basis risk is unclear in this context.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			between different days yield curves creating a movement in liabilities with no associated change in asset values, thereby leading to pro-cyclical effects. Long dated government debt is more likely to fall outside the ECB criteria across different days so could result in switching between methodologies for setting long-term interest rates which would further increase the basis risk. However, the problems are inherently less than for the euro zone as there is only one government credit rating. However the points raised above for euro countries where the actual rating is not AAA remains an issue.	
373.	PricewaterhouseCoopers LLP	3.35.	See comments under 3.37	See resolutions there.
374.	Prof. Antoon Pelsser, Maastricht University	3.35.	Change to principle based. Then we don't need to make the distinction between euro and other currencies.	Noted.
375.	CEA, ECO-SLV-09-434	3.36.	A level playing field should be ensured. In our opinion the methodology and principles chosen should be available for all relevant currencies ensuring consistency and a level playing field. Therefore, it is of vital importance that the same level of detail is provided under Level 2 for all currencies in order to ensure a level playing field is retained. CP40 currently provides different levels of guidance for the Euro relative to non-Euro currencies. It is important that this is not the case in the final version of Level 2, which should provide guidance to the same level of detail for all currencies.	Not agreed. It is neither necessary nor possible to specify the risk-free rates for all currencies at Level 2.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
376.	CRO Forum	3.36.	See 3.35.	See resolutions to 3.35.
377.	Dutch Actuarial Society – Actuariel Genootschap (	3.36.	See above	See resolutions above.
378.	German Insurance Association – Gesamtverband der D	3.36.	A level playing field should be ensured In our opinion the methodology and principles chosen should be available for all relevant currencies ensuring consistency and a level playing field. Therefore, it is of vital importance that the same level of detail is provided under Level 2 for all currencies in order to ensure a level playing field is retained. CP 40 currently provides different levels of guidance for the Euro relative to non-Euro currencies. It is important that this is not the case in the final version of Level 2, which should provide guidance to the same level of detail for all currencies.	Not agreed. It is neither necessary nor possible to specify the risk-free rates for all currencies at Level 2.
379.	PricewaterhouseCoopers LLP	3.36.	See comments under 3.37 A degree of judgement is required in assessing the characteristics described in 3.1.1, particularly given the current economic environment, leading to a high level of subjectivity in this area.	Noted.
380.	Prof. Antoon Pelsser, Maastricht University	3.36.	See above	See resolutions above.
381.	RBS Insurance	3.36.	It is stated that the risk free term structure implied by the UK government bond market does not satisfy all the suitability criteria	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			for use as a term structure in discounting reserves. This is likely as a result of supply/demand issues creating a technical bias. Therefore adjustments required.	
382.	CRO Forum	3.37.	We believe that all currencies should be dealt with at the same Level (i.e. Level 2), so as not to create inconsistencies and a non-level playing field. For countries, where one or more of the characteristics are not met, the principles addressing such a situation should be included at Level 2.	Agreed.
383.	Danish Insurance Association	3.37.	We would advice CEIOPS to study the Danish case – we have been applying a sensible term structure for liability valuation for years and have made a pragmatic adoption of that same term structure to reflect better Danish krone features in times of the financial crisis.	Noted.
384.	Dutch Actuarial Society – Actuariële Genootschap (	3.37.	See above	See resolutions above.
385.	European Insurance CFO Forum	3.37.	The basis of discounting for non-Euro currencies should be addressed in Level 2. Treatment of other currencies within and outside of the European Economic Area ('EEA') will not be addressed until Level 3. The basis of discounting for non-Euro currencies should be considered in Level 2 to ensure consistent implementation.	Not agreed. It is neither necessary nor possible to specify the risk-free rates for all currencies at Level 2.
386.	FFSA	3.37.	See 3.48	See resolutions to 3.48.
387.	Institut des	3.37.	We do not agree with the fact that the CEIOPS intends to legislate	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	actuaire (France)		the government bond rates for the euro zone and to postpone at level 3 the interest rate structure of other countries. Considering all the important differences that may occur, a special task force (see general comments) must be created in order to determine principles and rules in a coherent and homogeneous manner for all currencies.	
388.	PricewaterhouseCoopers LLP	3.37.	Risk free interest rate for non-Eurozone The risk free rate for other currencies will be a significant area of judgement in the technical provisions. We accept that this is an evolving area where further research and analysis will be required to determine the treatment (as evidenced in the Annexes to CP40). In addition, the approach adopted by each Member State is likely to evolve over time as economic conditions change. As such, we agree that Level 3 text is the most appropriate medium to address the treatment. This comment also refers to 3.35-6.	Noted.
389.	Prof. Antoon Pelsser, Maastricht University	3.37.	See above	See resolutions above.
390.	ROAM – Draft V2	3.37.	See 3.48	See resolutions to 3.48.
391.	XL Capital Ltd	3.37.	“The treatment of other currencies [than the euro] within and without the EEA would require further analysis at Level 3” Given the global nature of insurance business it seems incomplete / somewhat unbalanced for CEIOPS to provide Level 2 measures with regard to the euro, and not address other currencies.	Not agreed. It is neither necessary nor possible to specify the risk-free rates for all currencies at Level 2.
392.	European	3.38.	Detailed guidance is required to explain extrapolation and	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
	Insurance CFO Forum		interpolation techniques. The CFO Forum believes that the risk free interest rate curve should be based on swap rates plus an illiquidity premium. Swaps provide more data at longer durations than government bonds. Techniques are required to extrapolate and interpolate risk-free interest rate curve at the longer durations for AAA government bond curves. Additional guidance is required from CEIOPS around how to extrapolate and interpolate the risk-free curve to ensure consistency and comparability between companies. We recognise that there are several potential methodologies, including: R Extrapolation using money market rates as a proxy for very short durations. R Extrapolation using spot rates and an appropriate curve fitting methodology, for example: - o Applying a long-term limit (with the limit preferably being set at a level which allows the curve and forward rates to run smoothly toward the long-term limit as term increases); - o Assuming that either spot or forward rates remain level at the risk-free yield available at the longest term which represents a liquid data point; - o Applying the ratio of the swap yield to the government bond yield at the maximum liquid observable term of the swap yield to the government bond yields at longer durations; - o Where a relevant government bond yield curve exists which is longer than the swap yield curve, extending the

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			swap yield curve by maintaining a constant margin from the end of the swap curve and assuming it remains level thereafter; o Extension of yield curves beyond the horizon where markets are considered deep and liquid based on convergence to rolling average of last available data points with allowance for non-hedgeable risk for unmatched cash flows that are beyond last liquid point. R There should be no inflection points or turning points in the curve beyond the maximum observable term which represent a liquid data point unless this can be appropriately justified. R In territories where no swap market is available, a curve may need to be bootstrapped from observable government bond data. However, the current draft of IAS 39 provides a methodology on how a proxy rate should be determined without referencing government bond rates. The undertaking should be allowed to select the methodology that they consider to be the most appropriate while taking into account the principle of proportionality and materiality.	
393.	UNESPA (Association of Spanish Insurers)	3.38.	See comments to Para 3.59	
394.	European Insurance CFO Forum	3.39.	Comments in 3.38 are also relevant here.	
395.	UNESPA (Association of Spanish	3.39.	See comments to Para 3.59	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	Insurers)			
396.	CRO Forum	3.40.	We would like to reemphasize that the extrapolation technique should not lead to spurious volatility within the valuation exercise. However, the market consistency of the approach has to be taken into account as well.	
397.	DIMA (Dublin International Insurance & Management	3.40.	We support an extrapolation methodology which reduces volatility.	
398.	European Insurance CFO Forum	3.40.	Comments in 3.38 are also relevant here.	
399.	Munich RE	3.40.	We would like to reemphasize that the extrapolation technique should not lead to spurious volatility within the valuation exercise. However, the market consistency of the approach has to be taken into account as well.	
400.	UNESPA (Association of Spanish Insurers)	3.40.	See comments to Para 3.59	
401.	CRO Forum	3.41.	In general the feasibility of the method is crucial. Hence, the method has to be absolutely transparent and reworkable to enable a daily valuation.	
402.	European Insurance CFO Forum	3.41.	Comments in 3.38 are also relevant here.	
403.	Groupe	3.41.	The extrapolation of interest rates is an important issue. Whatever	

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	Consultatif		approach is taken, it will not be possible to “verify” the model used (as observations will not be available). The emphasis should be on a pragmatic approach, and the regulations should not lock into one overly specific approach	
404.	Munich RE	3.41.	In general the feasibility of the method is crucial. Hence, the method has to be absolutely transparent and rework able to enable a daily valuation.	
405.	UNESPA (Association of Spanish Insurers)	3.41.	See comments to Para 3.59	
406.	AVOE – Aktuarvereinigung Österreichs – Actuarial	3.42.	This method seems to lead to a high volatility and thus seems not suitable in our view.	
407.	CEA, ECO-SLV-09-434	3.42.	The simple extrapolation technique seems to not be particularly suitable, as it leads to high volatilities and is highly dependent on just one data point. This can lead to a very random interest rate level at the long end of the curve. In the light of this, insurers would tend to hedge against these long-term interest rate risks. However, it seems to be likely that it would be difficult to undertake a corresponding long-dated hedge since they are not unconditionally realisable on the capital market simply because the trading volume is not sufficient. The pressure to hedge against long-dated interest rate risks, however, tends to provoke market dislocations. As a result, it can be concluded that the use of the simple extrapolation method represents an interference with the business strategy of particularly life and health insurers (i.e. the diversification of risks over time)	

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
			such that costs may be shifted to customers. In addition, unstable long-term interest rate levels lead to highly volatile solvency ratios. This does not promote customer confidence.
408.	CRO Forum	3.42.	The stability of the method is seen as a major issue.
409.	European Insurance CFO Forum	3.42.	Comments in 3.38 are also relevant here.
410.	German Insurance Association – Gesamtverb and der D	3.42.	The simple extrapolation technique seems to not be particularly suitable, as it leads to high volatilities and is highly dependent on just one data point. 33. This can lead to a very random interest rate level at the long end of the curve. In the light of this, insurers would tend to hedge against these long-term interest rate risks. However, it seems to be likely that it would be difficult to undertake a corresponding long-dated hedge since they are not unconditionally realisable on the capital market simply because the trading volume is not sufficient. The pressure to hedge against long-dated interest rate risks, however, tends to provoke market dislocations. As a result, it can be concluded that the use of the simple extrapolation method represents an interference with the business strategy of particularly life and health insurers (i.e. the diversification of risks over time) such that costs may be shifted to customers. In addition, unstable long-term interest rate levels lead to highly volatile solvency ratios. This does not promote customer confidence.
411.	Groupe Consultatif	3.42.	The simple extrapolation leads to high volatility in the valuation, because it depends on one data point of sufficient liquidity. When insurance companies try to reduce their interest rate risk and hedge long-term cash flows, this yields downward pressure on the longer maturities in the term structure. As a result, it can be concluded that the use of the simple extrapolation method

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			represents an interference with the business strategy of particularly life and health insurers (i.e. the diversification of risks over time) such that costs are at the expense of the policyholders. In addition, unstable long-term interest rate levels lead to highly volatile solvency ratios. This does not promote customer confidence.	
412.	Just Retirement Limited	3.42.	The statement relating to the 10 year government bond rate being the "benchmark" for discount rates under Solvency I is not true for the UK market, and unlikely to be true of any other market which derives discount rates from the yield on the assets backing liabilities. Such markets are likely to be disproportionately affected by the introduction of risk-free discount rates and it is imperative that the impact assessment considers this point thoroughly.	
413.	Legal & General Group	3.42.	We agree that a simple extrapolation technique as described is appropriate.	
414.	RBS Insurance	3.42.	The importance of extrapolation is likely to be less material for non-life undertakings given the typically much shorter duration of non-life liabilities.	
415.	UNESPA (Association of Spanish Insurers)	3.42.	See comments to Para 3.59	
416.	Uniqa	3.42.	We definitely do not support the simple extrapolation technique. Beside the problem of dependence of the last liquid data point, it would lead to a discussion which data point is the last liquid. As this may differ by currencies, a general presetting by CEIOPS might not be possible. We believe it is a crucial lesson learned from the current financial crisis to establish measures for the calculation of the interest rate	

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
			term structure in times of illiquid and/or unreliable market environments. These measures or general rules must be defined beforehand in order to minimise national specificities and supervisory arbitrage in times of crisis.
417.	ACA – ASSOCIATION DES COMPAGNIES D'ASSURANCES DU	3.43.	In our opinion, it is not realistic to determine a robust equilibrium rate based on economic analysis. This analysis, conducted at different times would be based on different information sets and would necessarily lead to distinct conclusions.
418.	AMICE	3.43.	AMICE members strongly support the macroeconomic extrapolation technique which aims to introduce a method based on macroeconomic principles that will reduce the volatility in the long-end of the interest rate curve as opposed to an interest rate curve that is extrapolated from short term market rates in the absence of long term market interest rates AMICE believes that a principle-based approach should be developed in level 2. A more detailed approach should be developed as part of the Level 3 guidance.
419.	AVOE – Aktuarvereinigung Österreichs – Actuarial	3.43.	In our view this method seems to be the best of the three proposed approaches since avoiding volatilities by using less volatile macro-economic parameters. The danger of misstatement through faulty analysis might be overcome by applying gliding averages over some years (shorter than the 10 years applied under Solvency I). The crucial point seems to be the process on how to set a common "expert opinion". The gliding average approach (e.g. averaging the long term interest rates of the last 12 – 20 quarters) might also be a base for setting the long term interest rates under IFRS to avoid balance sheet

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
			reserves (with long tails) to be too volatile as well.
420.	CEA, ECO-SLV- 09-434	3.43.	The valuation by means of macroeconomic considerations appears a reasonable approximation to market-consistency. We believe that the Macroeconomic extrapolation technique is the most appropriate technique for extrapolation. However we should not preclude advances in this area in the future by setting out specific techniques at Level 2. Further work is needed to develop this. Obviously, appropriate harmonisation should be ensured through Level 3 measures.
421.	CRO Forum	3.43.	We see the merits of the macroeconomic extrapolation approach, we think that it can be embedded in a market consistent framework and that inputs into this method should be derived as much as possible from forward looking market data rather than historical data. Under advantages, 2nd paragraph, it is stated that the method is relatively insensitive to downward pressure in interest rate levels. Here we would like to emphasise that the method should include some sensitivity to fundamental drop in the interest rate level, so it should be avoided that the long-term equilibrium is only based on historical data and not on forward looking market data. Under disadvantages, 1st paragraph, it is stated that the long-term level can be misstated. We think that this disadvantage can be mitigated by basing the long-term equilibrium on market observable rates rather than a historical approach as e.g. proposed by B&H. E.g. long-term real rates can be observed from the difference in forward rates between 30yr nominal rates and 30yr inflation swaps in developed markets. Under disadvantages, 3rd paragraph, it is stated that the long-term equilibrium is not objective and mainly depends on expert opinion.

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
			We believe that we can set the long-term equilibrium based on market observable and objective information. E.g. independent inflation forecasts from industry surveys are available from Consensus Economics and are widely used in the financial industry.
422.	European Insurance CFO Forum	3.43.	Comments in 3.38 are also relevant here.
423.			Confidential comment deleted.
424.	German Insurance Association – Gesamtverb and der D	3.43.	The valuation by means of macroeconomic considerations is a reasonable method to determine the long-end of the risk-free term structure. The macroeconomic extrapolation technique, with a long-term equilibrium interest rate, is a reasonable technique as it tends to produce relatively stable results. After all macroeconomic fundamentals are not expected to be subject to ad-hoc changes. Stability is a crucial criterion that needs to be satisfied by the extrapolation method such that it can be ensured that solvency ratios follow a smooth path rather than fluctuating from month to month. Moreover we believe that the valuation by means of macroeconomic considerations is a reasonable approximation of market-consistency. After all, economic theory suggests that market prices are expected to revert to their average in the long-run (“mean reversion effect”). On these grounds we suggest to agree upon this type of extrapolation method at level 2 so as to reach an appropriate level of harmonisation. Details should be discussed at a later stage.
425.	Groupe Consultatif	3.43.	The Groupe is inclined to favour the macroeconomic approach, recognising that considerable care is required in implementation.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		We do believe that the ultimate interest rate needs to be kept under supervisory review, although the expectation should be that this would change only rarely and then by modest amounts. From our point of view macroeconomic extrapolation techniques in combination with mathematical techniques for a smooth extrapolation of market data is a reasonable approach for long-term valuations. The approach should be based on the longest observable market data (forward rates and forward rate volatilities), macroeconomic considerations for the long-term equilibrium level of the unconditional forward rate and a mean-reversion-effect of interest rates. Using appropriate mathematical techniques a smooth path from the longest observable interest rates to the long-term equilibrium level should be deduced from observed yield curve behaviour and interest rate volatility (e.g. an approach of Barrie&Hibbert for ultra long-term cash flows). This method tends to produce relatively stable results as macroeconomic fundamentals are not expected to be subject to ad-hoc changes. Stability is a crucial criterion that needs to be satisfied by the extrapolation method such that it can be ensured that solvency ratios follow a smooth path rather than fluctuating from month to month. The advantages of this method are the stability of the level and the limited impact on market prices, disadvantages are the remaining reinvestment risk in the valuation and possibly abrupt changes in the valuation when macroeconomic outlooks change. The definition of the mathematical approach and the fixing of the parameters should ensure a level playing field for European insurers, which excludes arbitrage between different countries. There are a number of variations on this method and where sufficient data exists yields can be extrapolated without needing to	

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			use macro-economics to set the ultimate target. The most important feature is that if the long-term forward rate is a constant then the spot rate will ultimately converge to the same rate. By fitting a parametric curve where both the spot rate curve and forward rate curve conform to the properties underlying the method set out in annex D then the long-term rate can be anchored by stipulating that at a certain time horizon the forward and spot rates converge. The advantage of such a parametric curve fitting method is that it doesn't overly depend on the final observable data point.	
426.	Just Retirement Limited	3.43.	We support the macroeconomic method as it avoids pro-cyclicality and technical distortions. The discounted value of very long-dated cashflows is by definition small and the potential risk of misvaluing claims that fall due in say 50 years' time should not be allowed to unduly influence current financial market prices. It is more important for undertakings to consider carefully the terms on which they will reinvest asset proceeds to meet very long-dated claim payments rather than to dwell on the valuation of the payments per se.	
427.	Legal & General Group	3.43.	There are a number of variations on this method and where sufficient data exists yields can be extrapolated without needing to use macro-economics to set the ultimate target. The most important feature is that if the long-term forward rate is a constant then the spot rate will ultimately converge to the same rate. By fitting a parametric curve where both the spot rate curve and forward rate curve conform to the properties underlying the method set out in annex D then the long-term rate can be anchored by stipulating that at a certain time horizon the forward and spot rates converge. The advantage of such a parametric curve fitting method is that it doesn't overly depend on the final observable data point.	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
428.	ROAM – Draft V2	3.43.	ROAM members support the macroeconomic extrapolation technique which aims to introduce a method based on macroeconomic principles that will reduce the volatility in the long-end of the interest rate curve as opposed to an interest rate curve that is extrapolated from short term market rates in the absence of long term market interest rates ROAM believes that a principle-based approach should be developed in level 2.	
429.	UNESPA (Association of Spanish Insurers)	3.43.	See comments to Para 3.59	
430.	AVOE – Aktuarvereinigung Österreichs – Actuarial	3.44.	This method also seems to lead to high volatilities and highly dependent on just one data point. This can lead to a very random interest rate.	Noted. CEIOPS believes that it is not possible to guarantee that one extrapolation method is the best in all circumstances and for all currencies. See the revised text in the final version of CP 40.
431.	CEA, ECO-SLV-09-434	3.44.	We would add to the advantages: that this method is consistent with the level 2 techniques e.g. transparent and that implicitly this method considers the forward rate of last data points as the current long term equilibrium rate. However, this method can lead to high volatilities and is highly dependent on just one data point. See comments to Para 3.42.	Noted. CEIOPS believes that it is not possible to identify a single extrapolation method performing best in all circumstances and for all currencies. See the revised text in the final version of CP 40.
432.	CRO Forum	3.44.	Within the class of parameterisation techniques the constant forward technique could be a promising approach. In countries	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			where there is limited market data available (e.g. just 10yrs) or where the last points of the curve might not be liquid, we believe that the forward rate method should be combined with the macroeconomic extrapolation method such that the forward rate used to extrapolate is moving from an observable forward rate towards a forward rate based on the macroeconomic approach.	Further work is needed to study this approach.
433.	Dutch Actuarial Society – Actuariële Genootschap (	3.44.	Inconsistent terminology: “Svensson model” in 3.32 is the same as “Nelson-Siegel class of models” here. Please use consistent terminology.	Agreed. Text in final version of CP 40 was amended.
434.	European Insurance CFO Forum	3.44.	Comments in 3.38 are also relevant here.	Noted.
435.	German Insurance Association – Gesamtverband der D	3.44.	We would add to the advantages: that this method is consistent with the level 2 techniques e.g. transparent and that implicitly this method considers the forward rate of last data points as the current long term equilibrium rate. However, this method can lead to high volatilities and is highly dependent on just one data point See comments to Para 3.42	Noted. See resolution regarding comments no. 430 and no. 431.
436.	Groupe Consultatif	3.44.	Depending on the method, parameterisation techniques may lead to high volatility in the valuation, in particular when they depend on one data point of sufficient liquidity. In that case, when insurance companies try to reduce their interest rate risk and hedge long-term cash flows, this yields downward pressure on the longer maturities in the term structure. As a result, it can be concluded that the use of the simple extrapolation method represents an	Noted. See resolution regarding comments no. 430 and no. 431.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			interference with the business strategy of particularly life and health insurers (i.e. the diversification of risks over time) such that costs are at the expense of the policyholders. In addition, unstable long-term interest rate levels lead to highly volatile solvency ratios. This does not promote customer confidence.	
437.	Legal & General Group	3.44.	The disadvantage stated in relation to the constant forward rate assumption does not necessarily depend on the final observable data point and actually points to a weakness in the implementation not the approach. The method of yield curve fitting we have used over a number of years is a parametric technique that pre-ceded the Barrie & Hibbert fitting method but possesses similar properties. Our method has provided accurate fits to yield curves across the observable data and the long-term extrapolations have been reasonable. It should be noted that insurers with long-dated liabilities, for example annuities also have shorter dated liabilities and therefore there comes a point where the extrapolation has little material impact on the total liabilities. Issues of very long-term extrapolation of yields, depending on the firms' liability profile beyond 30 to 50 years are often overstated.	Noted. See resolution regarding comments no. 430 and no. 431.
438.	OAC plc	3.44.		
439.	Prof. Antoon Pelsser, Maastricht University	3.44.	Inconsistent terminology: "Svensson model" in 3.32 is the same as "Nelson-Siegel class of models" here. Please use consistent terminology.	Agreed. See resolution regarding comment no. 433.
440.	UNESPA (Association of Spanish Insurers)	3.44.	See comments to Para 3.59	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
441.	ASSOCIATION OF FRIENDLY SOCIETIES (AFS)	3.45.	We believe it will be impossible for CEIOPS to have any range of solutions available that will stand the test of time and will be able to cover all currencies (including non EEA currencies) at all times. We would strongly recommend that CEIOPS abandon an attempt to derive a single method and should allow firms to use any method they believe is appropriate and explain the method used. The supervisor can then take issue with any method that it believes is an abuse.	Not agreed. CEIOPS agrees that it is difficult to define one single method that is equally appropriate for all currencies, at all times. But the extrapolation method can not be at the discretion of the particular company, as this would lead to a lack of harmonisation. CEIOPS aims at choosing on Level 3 for each currency the extrapolation method that is appropriate at a given time. See the revised text of the final version of CP 40.
442.	CEA, ECO-SLV-09-434	3.45.	44. A level playing field should be ensured – there is a danger that this will not happen with a ‘comply or explain’ mechanism in place.	Noted. See the revised text of the final version of CP 40.
443.	CRO Forum	3.45.	We see the danger that we could create a situation where we do not end up with a level playing field.	Noted. See the revised text of the final version of CP 40.
444.	DIMA (Dublin International Insurance & Management	3.45.	We support an approach that leads to maximum harmonisation and reliability. In this regard we would endorse an approach where CEIOPS proposes a specific extrapolation for each currency as opposed to all currencies thus addressing the concerns outlined by CEIOPS noting that the concern is less to do with the currency of the supervisor’s local currency but with the international currencies that reside in the portfolios of the undertaking that are regulated by the local supervisor.	Noted. See the revised text of the final version of CP 40.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
445.	Dutch Actuarial Society – Actuariële Genootschap (	3.45.	Strongly agree with “comply or explain” procedure.	Noted.
446.	European Insurance CFO Forum	3.45.	Comments in 3.38 are also relevant here.	Noted.
447.	German Insurance Association – Gesamtverband der D	3.45.	35. A level playing field should be ensured – there is a danger that this will not happen with a ‘comply or explain’ mechanism in place	Noted. See the revised text of the final version of CP 40.
448.	Groupe Consultatif	3.45.	We are concerned that a ‘comply or explain’ approach could weaken the overall harmonisation objective of the Solvency 2 regime and create arbitrage opportunities.	Noted. See the revised text of the final version of CP 40.
449.	Investment & Life Assurance Group (ILAG)	3.45.	We believe it will be impossible for CEIOPS to have any range of solutions available that will stand the test of time and will be able to cover all currencies (including non EEA currencies) at all times. We would strongly recommend that CEIOPS abandon an attempt to derive a single method and should allow firms to use any method they believe is appropriate and explain the method used. The supervisor can then take issue with any method that it believes is an abuse.	Not agreed. CEIOPS agrees that it is difficult to define one single method that is equally appropriate for all currencies, at all times. But the extrapolation method can not be at the discretion of the particular company, as this would lead to a lack of harmonisation. CEIOPS aims at choosing on Level 3 for each currency the extrapolation

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
				method that is appropriate at a given time. See the revised text of the final version of CP 40.
450.	Just Retirement Limited	3.45.	Given the differences between term structures in different currencies and in different markets, we strongly support the "comply or explain" procedure. It is imperative that insurance regulation does not materially distort interest rate markets and lead to pro-cyclicality.	Noted. See the amended text of the final version of CP 40
451.	KPMG ELLP	3.45.	While we agree that the 'comply or explain' may lead to divergence of approaches and less harmonisation, we are of the view that it may be the best approach. (Re)insurance undertakings should be able to choose an approach that is suitable for their own circumstances as long as they can explain and justify the approach and demonstrate that it is in line with the specified principles.	Not agreed. The extrapolation method can not be at the discretion of a particular company, as this would lead to a lack of harmonisation.
452.	Legal & General Group	3.45.	We do not believe that CEIOPS should specify a particular technique for extrapolating interest rates. It is preferable to set a series of principles for extrapolating interest rates. There would then be an objective way of deciding whether the method used by a firm is appropriate.	Partially agreed. CEIOPS aims at setting up a set of principles for extrapolating interest rates at Level 3. But the extrapolation method can not be at the discretion of a particular company, as this would lead to a lack of harmonisation. See the amended text of the final version of CP 40
453.	Munich RE	3.45.	We see the danger that we could create a situation where we do not end up with a level playing field.	Noted.
454.	OAC plc	3.45.	We do not believe that CEIOPS should specify a particular	Partially agreed.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			technique for extrapolating interest rates. It is preferable to set a series of principles for extrapolating interest rates. There would then be an objective way of deciding whether the method used by a firm is appropriate.	See resolution regarding comment no. 452.
455.	PricewaterhouseCoopers LLP	3.45.	Extrapolation methods There will inevitably be significant judgement in the extrapolation from the last liquid data point. Given this, transparency (through disclosure) and point in time consistency will be important. We acknowledge the advantages of the CEIOPS aim for a single specified method for extrapolating the interest rate structure. However, we caution: R A single approach may not be appropriate for all currencies and all future time periods where the shape of the curve and depth of liquidity may significantly differ. R This is likely to be an area where best practice evolves over time. Consequently, it may be better to define the features of an appropriate extrapolation method in Level 2 text rather than prescribing a single method. Assuming a single method is prescribed, we welcome the suggestion of a “comply or explain” procedure which would allow Member State supervisors to choose the application of a different extrapolation technique in their own currency area. To ensure harmonisation under the “comply or explain” procedure, it will be necessary for further guidance over its application to be specified in Level 2 or Level 3 text. We would also like to draw two other considerations to your attention:	Agreed. See the amended text of the final version of CP 40

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			R There has been significant research into the extrapolation of interest rate term structures which should be considered. For example, the recent work by Barrie & Hibbert, see: "A framework for estimating and extrapolating the term structure of interest rates" - September 2008. R There is no mention of extrapolation at the short-end where money market rates should be considered as well. This comment also refers to 3.47 and 3.59.	Noted.
456.	RBS Insurance	3.45.	We support a "comply or explain" approach if a satisfactory methodology for all member states cannot be found.	Noted.
457.	UNESPA (Association of Spanish Insurers)	3.45.	See comments to Para 3.59	Noted
458.	Uniqa	3.45.	As the setting of the interest term structure is one of the major assumptions in the valuation process and has a big impact on the results, we do not believe that a 'comply or explain' procedure will only lead to less harmonisation but will end up in not comparable results.	Noted. See the amended text of the final version of CP 40
459.	CEA, ECO-SLV-09-434	3.46.	We do not support this method - it does not result in the harmonisation of extrapolation techniques. This article suggests that the "constant spread method" is based on "one unique extrapolation technique for all currencies". Strictly speaking, this is not correct. In the example provided, there is no extrapolation for the EUR, but there is an extrapolation for non-EUR currencies. This extrapolation technique is only the same for all non-EUR currencies. Basically, different extrapolation techniques for EUR and for non-EUR are used.	Noted. CEIOPS aims at setting up a set of principles at Level 3 that provide a basis when deciding on an appropriate extrapolation method for each currency at a given time. The Euro-spread method – constant or variable spread - is at this stage seen as

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			Furthermore, the key assumption of this technique - that the spread between the currencies remains constant from the last liquid data point for all future durations - is a very strong assumption that we would not necessarily expect to hold and it would cause significant sensitivity to currency risk against the Euro which we would wish to avoid.	one method amongst several potentially eligible methods. See the amended text of the final version of CP 40
460.	CRO Forum	3.46.	The proposed 'constant spread method' for extrapolating yield curves for non-Euro currencies does not take into consideration differences in the shapes of yield curves of different currencies prior to the last available liquid data point that applies to both currencies and therefore we do not believe that this method is appropriate in its current form. However, if refined it could be an interesting technique. It should be based on observed forward rates rather than a single point on the curve. We have embedded a similar technique into the macroeconomic extrapolation approach. In particular we observed convexity premia in long dated EUR and USD curves for tenors between 20 and 50 years and apply such convexity premia also to other currencies as a fixed negative spread to the macroeconomic nominal forward rate. For example, if the Euro curve is steep upwards sloping and a non-Euro curve is steep downwards sloping with the last mutually available liquid data point being the point where the two curves cross, then the non-Euro curve will be extrapolated to be steep upwards sloping despite being steep downwards sloping prior to the last available liquid data point.	Noted. See the resolution regarding comment no. 459. CEIOPS agrees that further work has to be done on Level 3.
461.	German Insurance Association –	3.46.	We do not support this method - it does not result in the harmonisation of extrapolation techniques This article suggests that the "constant spread method" is based on	Noted. See the resolution regarding comment no. 459.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	Gesamtverb and der D		"one unique extrapolation technique for all currencies". Strictly speaking, this is not correct. In the example provided, there is no extrapolation for the EUR, but there is an extrapolation for non-EUR currencies. This extrapolation technique is only the same for all non-EUR currencies. Basically, different extrapolation techniques for EUR and for non-EUR are used. Furthermore, the key assumption of this technique - that the spread between the currencies remains constant from the last liquid data point for all future durations - is a very strong assumption that we would not necessarily expect to hold and it would cause significant sensitivity to currency risk against the Euro which we would wish to avoid.	
462.	Groupe Consultatif	3.46.	We recognise the potential applicability of this technique but believe regard should be had to the term structure of the spread against euro at earlier more liquid data points. One might expect the spread to be term dependent (especially for "weaker" currencies)	Noted CEIOPS agrees that further work has to be done on Level 3.
463.	Legal & General Group	3.46.	We disagree with the paragraph; it is pro-cyclical and breaks most of the characteristics set out in 3.3.	Noted.
464.	Lucida plc	3.46.	We do not believe the constant spread technique is appropriate in all cases.	Agreed.
465.	Pricewaterho useCoopers LLP	3.46.	Constant spread method of extrapolation The "constant spread" method described in this paragraph is not appropriate as it does not take account of the shape of the curve before the last available liquid data point. Consider the plausible situation where the Eurozone curve is downward sloping at all data points and the UK pound sterling	Noted. See the resolution regarding comment no. 460.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			curve is upward slope up to last liquid data point. The “constant spread” method would introduce a point of inflexion at the last liquid data point where after the UK pound sterling curve would be downwards sloping. That is to say that the extrapolation method would result in a “humped” shape curve for UK pound sterling. This is not an appropriate extrapolation method. This comment also refers to 3.59.	
466.	UNESPA (Association of Spanish Insurers)	3.46.	See comments to Para 3.59	Noted.
467.	Association of British Insurers	3.47.	Macroeconomic extrapolation techniques, with a long-term equilibrium interest rate, may be an appropriate technique for certain currencies, however further work is needed to develop these ideas. Obviously, appropriate harmonisation should be ensured through Level 3 measures. We support the CEA’s proposed principles for the extrapolation techniques: R Consistency with the objectives of Solvency II R Risk manageable – the method should facilitate risk management, which in practice means that there should be a meaningful link between the liquid part of the curve and the non-liquid curve so that use can be made of liquid hedging instruments. R Economic valuation – as far as possible the extrapolation should reflect economic realities, i.e. the long term economic equilibrium position as opposed to a mechanical extrapolation that results in economically counter-intuitive and inconsistent results. R Reduce pro-cyclicality – minimise the possible effect that	Noted. See the amended text of the final version of CP 40

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			insurance liability valuation approaches encourage a cycle of trading behaviour in adverse markets that results in a downward spiral for solvency positions because of the link between liability valuations and market data. This is particularly relevant for illiquid parts of the market as these are by definition more vulnerable to this. R Convergence to market-consistency – full use should be used of market data where it is sufficiently liquid to be reliable. Thereafter market data should be blended into a relatively stable and economically sensible extrapolated position. The method should be flexible enough to adapt should markets become more liquid and allow greater use to be made of market data as appropriate.] R Parsimony - the least complex appropriate approach should be adopted. In general this means methods involving fewer and simpler parameters, which helps achieve harmonisation and long-term stability.	
468.	BARRIE & HIBBERT	3.47.	This comment also applies to B.14-B.15. The valuation of ultra long-term cash flows that fall beyond the maturity of the longest bonds traded in fixed income markets is a fundamental challenge. You could argue it is the most basic valuation task faced by firms. For some territories (for example, some of the Asian and emerging European economies) the approach used will have a 'first-order' impact on the balance sheet. Developing sound approaches turns out not to be straightforward. As the CPs acknowledge, the simple approaches of extrapolating with constant forward or spot rates have little economic justification (in fact there is justification for not using constant spot rates) and have the potential to create damaging, spurious volatility on an insurer's balance sheet (see our report "Market-consistent valuation	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		of ultra long-term cash flows”, October 2008). In summary, transferring all of the variability in longest (and error-prone) forward rates to the entire term structure has little economic rationale and generates unreasonable volatility in long-term liability values. We have published a series of papers (see footnote1) concerned with: R Fitting market data R Setting a long-term, limiting (forward) interest rate assumption R Setting a plausible path between observed market data and the limiting rate. The justification for the macroeconomic extrapolation is that it produces long term discount rates with similar levels of volatility to those observed in markets where long maturity bonds are available. In Annex B reference is made to the B+H framework for extrapolating the term structure of interest rates. The B+H framework is composed of 4 components: R A very long term real yield R A very long term inflation assumption R A convexity adjustment R A nominal term premium adjustment In paragraph B.15 it is stated that the use of the last two components is more debatable than the first two components. The argument for the second two components is as follows: Convexity adjustment	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		This is a feature of any yield curve where there is uncertainty about future rates. Since the return on a bond is different for a given rise in rates compared to the same fall in rates, as uncertainty increases – all other things equal - long rates must be lower than short rates to equalise expected returns (see footnote2). Nominal term premium Risk premia play an important part in shaping yield curves. In recent years, most practitioners would argue that long-term rates have been reduced by the strong demand for long-term bonds from investors. However, over the very long-term, the longest available bonds have tended to offer a higher return than short-dated instruments – a maturity or term premium. Our view is that the limiting forward rate should be set in line with an unconditional view (i.e. independent of today's market conditions) of the term premium. In our work, we assume this is positive. It would be quite possible (and some experts would argue reasonable) to set this to zero. For both these assumptions, we believe the key consideration should be consistency. Firms and regulators should avoid creating spurious variability in the value of unobservable, non-traded, ultra long-term insurance liabilities by moving these assumptions over time except where there is very strong evidence to support a change. In choosing a convexity and term premium assumption, the question is not whether you are comfortable with it today, but whether you would also have been able to live with it in 1980 and 1930 as well as today. The use of a term premium is also related to the calculation of the risk margin and CP-42. Using the methods we have proposed the term premium is calibrated to reproduce the market risk premium that is observed for the longest available bond and the	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			CEIOPS-SEC-103-09
		unconditional (limiting) risk premium. The method produces extrapolated market prices that reflect the risk margins that are evident in the market. The transition from the market risk premium to the unconditional economist's assumption is gradual. This is deliberate and means that short-term volatility in risk premia is not propagated across the entire maturity spectrum. It is this feature of the B+H methodology that makes the CP-42 risk margin calculation redundant for interest rate extrapolation. CP40 lists two disadvantages of the macroeconomic extrapolation approach: 1. "the method is sensitive to the choice of maturity for the long term equilibrium rate". We view this question slightly differently. Our proposed method sets a limiting forward interest rate but does not say when it is reached in the extrapolation. Separately, we specify the rate of decay in the volatility of forward rates which will determine the speed with which the longest market rate moves to the equilibrium assumption. In practice forward rates will be close to the unconditional assumption after 100 years. Spot and coupon rates could still be materially different, even at a 100 year horizon. 2. "the method is sensitive to changes in the long term equilibrium macro economic variables". This is true and there is no way of avoiding this fundamental valuation judgment. This is true of any approach but using our methodology the assumption is explicit. As a result we are able to impose consistency and stability. By contrast, whilst superficially appealing, extrapolating using the longest spot or forward rate implicitly says that the equilibrium rate is as volatile as the, say, a 30-year rate (or a 10-year rate in less developed markets). This makes no sense and tends to undermine the whole market-	Noted. See the amended text of the final version of CP 40

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			consistent, economic basis of Solvency II valuations. Footnotes: ¹ We have published a number of research reports on this subject: "<i>Exposure Draft: A framework for estimating and extrapolating the term structure of interest rates</i>", September 2008; "<i>Fitting the Yield curve: Spline interpolation and Nelson-Siegel extrapolation</i>", September 2008; "<i>Interest rate calibration: How to set long-term interest rates in the absence of market prices</i>", September 2008; "<i>Real-world interest rate calibration: How to construct a volatility term-structure of interest rates in the absence of market prices</i>", September 2008; "<i>A comparison of extrapolation performance: Flat forwards vs B+H method for USD curves (1985-2007)</i>", November 2008. ² For a thorough, non-technical explanation of yield curve dynamics see the excellent "<i>Forces That Shape the Yield Curve: Parts 1 and 2</i>", Mark Fisher, Federal Reserve Bank of Atlanta, Working Paper 2001-3, March 2001.	
469.	CEA, ECO-SLV-09-434	3.47.	The CEA believes that it is important that no specific extrapolation technique is specified at Level 2, rather the principles that should be met by the technique are provided. Macroeconomic extrapolation techniques, with a long-term equilibrium interest rate, may appear to be an appropriate technique for certain currencies currently, however we should not preclude advances in this area in the future by setting out specific techniques at Level 2. Further work is needed to develop this. Obviously, appropriate harmonisation should be ensured through	Noted. See the amended text of the final version of CP 40

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate		
		Level 3 measures. The CEA believes that the extrapolation techniques used should adhere to the following principles: R Consistency with the objectives of Solvency II R Risk manageable – the method should facilitate risk management, which in practice means that there should be a meaningful link between the liquid part of the curve and the non-liquid curve so that use can be made of liquid hedging instruments. R Economic valuation – as far as possible the extrapolation should reflect economic realities, i.e. the long term economic equilibrium position as opposed to a mechanical extrapolation that results in economically counter-intuitive and inconsistent results. R Reduce pro-cyclicality – minimise the possible effect that insurance liability valuation approaches encourage a cycle of trading behaviour in adverse markets that results in a downward spiral for solvency positions because of the link between liability valuations and market data. This is particularly relevant for illiquid parts of the market as these are by definition more vulnerable to this. R Convergence to market-consistency – full use should be used of market data where it is sufficiently liquid to be reliable. Thereafter market data should be blended into a relatively stable and economically sensible extrapolated position. The method should be flexible enough to adapt should markets become more liquid and allow greater use to be made of market data as appropriate. R Parsimony - the least complex appropriate approach should be adopted. In general this means methods involving fewer and simpler parameters, which helps achieve harmonisation and long-

Noted.

CEIOPS aims at setting up a set of principles at Level 3 that provide a basis when deciding on an appropriate extrapolation method for each currency at a given time and is grateful to input from stakeholders on this issue.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			term stability.	
470.	CRO Forum	3.47.	As all extrapolation methods have their merits and drawbacks a simple and robust method should be used. We recommend that the undertakings should be allowed to use the most appropriate approach, in light of the available data, so long as they clearly disclose the adopted extrapolation method. However, if one single approach had to be taken we advocate the simplest form of extrapolation, i.e. the extrapolation of the last liquid data point on the spot curve. We would also like to stress that we see a sufficiently liquid market in the EUR up to 30 years in the swap curve. Subsequently, an extrapolation should set up on this data point in EUR and not at shorter durations. However, such an approach may not be a practical one for the Asia region where the availability of data is not as comprehensive and the Euro region.	Not agreed. The extrapolation method can not be at the discretion of each undertaking, as this would lead to a lack of harmonisation. Noted.
471.	Danish Insurance Association	3.47.	In the Danish case we have on a pragmatic basis chosen to extrapolate from the last data point with sufficient liquidity.	Noted.
472.	Deloitte Touche Tohmatsu	3.47.	We favour an extrapolation technique that is as simple and objective as possible. A macroeconomic model based on a long-term unconditional forward rate is in our opinion not objective, since the level of the forward interest rate is a matter of (rather arbitrary) choice. We think the macro-economic approach can only work if CEIOPS specifies a hard-coded long term interest rate (for example, 4%); otherwise some may take advantage of flexibility in calibration to choose rates that give particularly high or low liabilities. We note that the apparent stability may be overstated. For example, if CEIOPS had specified 4% and then market yields moved to 15% at	Noted. See the amended text of the final version of CP 40

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			all observable terms, CEIOPS would come under pressure to change the “fixed” long limit, but to do so in one large jump. CEIOPS would therefore need to specify clearly the principles for reviewing the long rate so that insurers can mitigate the risks to their balance sheets. Parameterisation models could suffer from irregular shapes of the yield curve, where the model may break down (e.g. Nelson Siegel not being able to model an inverse slope in the short-term part of the yield curve). This leaves the simple extrapolation as the remaining possibility. On balance, we still consider that extrapolation techniques represent the best approach, despite the disadvantages listed. Rather than only basing this extrapolation on the last data point however, it could be considered to use a series of data points (e.g. extrapolating the 20Y to 30Y data points) for extrapolation. This approach would benefit from the approach suggested in 3.46, due to the availability of the long-duration govt. bonds. However, we support CEIOPS’ consideration of a “possibility of allowing a ‘comply or explain’ procedure for the extrapolation method” where the chosen technique appears to be inapplicable.	
473.	European Insurance CFO Forum	3.47.	Comments in 3.38 are also relevant here.	Noted
474.	German Insurance Association – Gesamtverb and der D	3.47.	The macroeconomic extrapolation technique is most sensible and should be applied. However, any possible extrapolation technique should adhere to the following principles: R Consistency with the objectives of Solvency II R Risk manageable – the method should facilitate risk management, which in practice means that there should be a	Noted. See resolution regarding comment no. 469.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			meaningful link between the liquid part of the curve and the non-liquid curve so that use can be made of liquid hedging instruments. R Economic valuation – as far as possible the extrapolation should reflect economic realities, i.e. the long term economic equilibrium position as opposed to a mechanical extrapolation that results in economically counter-intuitive and inconsistent results. R Reduce pro-cyclicality – minimise the possible effect that insurance liability valuation approaches encourage a cycle of trading behaviour in adverse markets that results in a downward spiral for solvency positions because of the link between liability valuations and market data. This is particularly relevant for illiquid parts of the market as these are by definition more vulnerable to this. R Convergence to market-consistency – full use should be used of market data where it is sufficiently liquid to be reliable. Thereafter market data should be blended into a relatively stable and economically sensible extrapolated position. The method should be flexible enough to adapt should markets become more liquid and allow greater use to be made of market data as appropriate. R Parsimony - the least complex appropriate approach should be adopted. In general this means methods involving fewer and simpler parameters, which helps achieve harmonisation and long-term stability.	
475.	Munich RE	3.47.	As all extrapolation methods have their merits and drawbacks a simple and robust method should be used. It should be taken into account that the method is commonly used and also available or easily implemented in the standard software packages. This is amongst other things important as the economic balance sheet is also the basis for market risk evaluation. We would like to	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			reemphasis that the extrapolation technique should not lead to spurious volatility within the valuation exercise. However, the market consistency of the approach has to be taken into account as well. We recommend that the undertakings should be allowed to use the most appropriate approach, in light of the available data, so long as they clearly disclose the adopted extrapolation method.	Not agreed. The extrapolation method can not be at the discretion of each undertaking, as this would lead to a lack of harmonisation.
476.	PricewaterhouseCoopers LLP	3.47.	See comments under 3.45	Noted.
477.	UNESPA (Association of Spanish Insurers)	3.47.	See comments to Para 3.59	Noted.
478.	ACA – ASSOCIATION DES COMPAGNIES D'ASSURANCES DU	3.48.	About the risk free rate for a given currency, if an insurance company has a freedom to provide services business in different currencies but it is sometimes marginal compare to € currency portfolio, is there a threshold under which it's admitted that the main currency risk free rate could be used or not?	No. The currency should always be matched.
479.			Confidential comment deleted.	
480.	CEA, ECO-SLV-09-434	3.48.	See comments to Para 3.35 and 3.36.	See resolutions there.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
481.	Dutch Actuarial Society – Actuarieel Genootschap (	3.48.	First mention the principles of 3.53. Change wording of 3.48: line 2: ...be defined following a set of principles.	Noted.
482.	European Insurance CFO Forum	3.48.	To ensure consistency and comparability, the underlying methodology adopted should be consistent with the MCEV framework, when finalised, as this is also based on economic principles.	Noted.
483.	FFSA	3.48.	Definition of risk-free interest rate for each currency: CEIOPS indicates that a uniform methodology is expected to be followed for a given currency. It is not clear at that stage how consistency will then apply among currencies. The use of the government bond structure built by ECB is quite straightforward according to this CP (3.34), the definition of the relevant risk-free rate term structure for other currencies is postponed at level 3 (3.37). FFSA completely disagrees with CEIOPS' approach (3.34 & 3.37) and considers that to avoid market distortions and insure consistency CEIOPS should define the relevant risk-free term structure for all currencies at Level 2.	Noted. Not agreed. It is neither necessary nor possible to specify the risk-free rates for all currencies at Level 2.
484.	German Insurance Association – Gesamtverband der D	3.48.	See comments to Para 3.35 and 3.36	See resolutions there.
485.	KPMG ELLP	3.48.	We agree that a uniform methodology will assist with comparability	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			across the industry.	
486.	Lloyd's	3.48.	We agree, but highlight the importance of proportionality. The paper states that for each currency the interest rate term structure should be defined, suggesting that every liability should be valued at a risk free rate determined in the original currency. This may not be practical for firms which underwrite a diverse book of international business which have a number of small sub-portfolios with liabilities in non-major currencies. For these small currency segmentations firms should be allowed to group different currencies together and value using an appropriate term structure. Where firms have approximated the term structure they should document any approximations for the supervisor to assess the reasonableness of any approximations.	Not agreed. The discount rate should always match the currency of the obligations.
487.	PricewaterhouseCoopers LLP	3.48.	See comments under 3.14	See resolutions there.
488.	Prof. Antoon Pelsser, Maastricht University	3.48.	First mention the principles of 3.53. Change wording of 3.48: line 2: ...be defined following a set of principles.	Noted.
489.	RBS Insurance	3.48.	Whilst a uniform methodology is desirable, we support a "comply or explain" approach if the anomalies produced for the UK market when using gilts cannot be resolved.	Noted.
490.	ROAM – Draft V2	3.48.	Definition of risk-free interest rate for each currency: CEIOPS indicates that a uniform methodology is expected to be followed for a given currency. It is not clear at this stage how consistency will then apply among currencies. The use of the government bond structure constructed by ECB is quite straightforward according to this CP (3.34), the definition of the	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			relevant risk-free rate term structure for other currencies is postponed to level 3 (3.37). ROAM completely disagrees with CEIOPS' approach (3.34 & 3.37) and considers that to avoid market distortions and insure consistency CEIOPS should define the relevant risk-free term structure for all currencies at Level 2.	Not agreed. It is neither necessary nor possible to specify the risk-free rates for all currencies at Level 2.
491.			Confidential comment deleted.	
492.	FFSA	3.49.	Definition of risk-free interest rate for each valuation date: CEIOPS says that: the relevant risk-free rate should be determined on the basis of market data relevant for the valuation date. For non euro currencies, relevant market data are not defined in this CP with the exception of UK pounds sterling for which the UK Financial Supervisor Authority suggests the use of a swap adjusted curve (Appendix C). FFSA considers that the relevant market data should be defined with a consistent approach and in level 2 for all currencies.	Not agreed. It is neither necessary nor possible to specify the risk-free rates for all currencies at Level 2.
493.	KPMG ELLP	3.49.	We agree that market data should be used to determine the risk free term structure as far as this is possible.	Noted.
494.	Lloyd's	3.49.	We agree.	Noted.
495.	ROAM – Draft V2	3.49.		Noted.
496.	ACA – ASSOCIATION DES COMPAGNIES D'ASSURAN	3.50.	Wouldn't it be more consistent if the regulator provides risk-free interest rate term structure for each currency on the basis of the methodology described in the sub chapter 3.55. ?	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	CES DU			
497.			Confidential comment deleted.	
498.	FFSA	3.50.	Relevant risk rate for each currency and valuation date: CEIOPS says that: the risk-free rate term structure should be the same for each insurance or reinsurance company for a given currency and valuation date. Therefore, FFSA would like the CEIOPS to confirm it excludes any adjustment relating to branch or entities specificities such as allowance for the degree of liabilities illiquidity or the asset liability management strategy. Furthermore, CEIOPS should pay a special attention when one country's spread on the risk free rate is volatile. Indeed, as in general local companies invest in local government bonds, if a country spread widen, coupled with a market consistent approach, this will drive to an important decrease of economic own funds. Such measure, penalizing non-AAA rated states bonds, could result in important (macro)-economic impacts, as (re-)insurers would avoid investing in volatile governments bonds.	Noted.
499.	KPMG ELLP	3.50.	We are sympathetic to the CEIOPS viewpoint that a single term structure for a given currency and valuation date would aid comparability between (re)insurance undertakings. However we feel that this presents a unique challenge in the Euro-zone. To achieve the same discount rate across the Euro-zone area the rate of choice would be the swap rate as this is the same for every jurisdiction within the Euro-zone. However by choosing the government rate, and in particular the ECB rate which is largely driven by French and German government bond markets, insurance supervision will start to create technical biases in government debt funding in the Euro-zone area.	Noted. Not agreed. Swap rates are not risk-free.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			It has to be borne in mind that Euro-denominated government debt is not backed by a single European Government with its own tax raising powers. It is issued by individual governments which have different probabilities of default and consequently spreads. Therefore applying an essentially French and German risk free rate to all countries in the Euro-zone could well create artificially high demand for French and German debt and artificially low demand for other debt. Unless there was sufficient bond issuance by Paris and Berlin, low euro-zone rates would raise the cost of long term insurance protection in a similar manner to the way that real interest rates collapsed in the UK due to pension funds hedging their long term liabilities. It would be helpful to understand if the consequences of adopting the approach proposed have been fully discussed and digested with the ECB and, perhaps more importantly, if the bodies responsible for setting policy on government debt issuance within each Euro-zone country have fully understood and digested how this will impact the cost of raising debt in their domestic market. It was not evident in the impact assessment Excel file that this had been given due consideration. Our view is that using swap rates or allowing Euro-zone countries to use their own domestic bond curve would offset these issues. Domestic government bond curves could however still give rise to technical bias if issuance was low. Using the swap rate would alleviate these issues.	
500.	Legal & General Group	3.50.	We do not agree with this advice. For appropriate liabilities, an insurance undertaking should be able to recognise a liquidity premium in its risk free interest rate term structure.	Noted.
501.	Lloyd's	3.50.	We agree, subject to proportionality.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
502.	OAC plc	3.50.	We do not believe that that it is necessary or desirable for a given currency and valuation date for all undertakings to use a same relevant risk-free interest rate term structure. For the reasons for this see our response comments on paragraph 3.54.	Noted.
503.	PricewaterhouseCoopers LLP	3.50.	See comments under 3.34	See resolutions there.
504.			Confidential comment deleted.	
505.	KPMG ELLP	3.51.	We agree with this statement.	Noted.
506.	ASSOCIATION OF FRIENDLY SOCIETIES (AFS)	3.52.	We would remind CEIOPS that firms' year ends may not be at a quarter end. The rates must be capable of being derived on a market consistent basis at any working day to ensure liabilities are valued at a consistent basis to assets. If CEIOPS publishes rates, it will need to do so at least daily.	Not agreed. It is not feasible for CEIOPS to publish rates on a daily basis.
507.			Confidential comment deleted.	
508.	CEA, ECO-SLV-09-434	3.52.	See comments to Para 3.35, 3.36 and 3.20.	See resolutions there.
509.	Danish Insurance Association	3.52.	Providing the term structure on a quarterly basis is not very ambitious. In Denmark, it is provided on a daily basis.	Not agreed. It is not feasible for CEIOPS to publish rates on a daily basis.
510.	European Insurance CFO Forum	3.52.	Comments in 3.48 are also relevant here.	See resolutions there.
511.	FFSA	3.52.	CEIOPS role in defining the relevant risk free rate term structure : CEIOPS suggests providing both the relevant risk free rate term	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			structure and uniform methodology for all major currencies at least quarterly, and indicates that term structure of the EEA currencies may be provided more frequently if market conditions are volatile. FFSA would like the relevant risk free rate term structure to be determined in the same way (same hierarchy level) and update at the same time for all currencies. For instance, if the CEIOPS provides the Euro relevant risk free rate curve, it should also provide the curve for other currencies. FFSA disagrees with a process where some members' state would be provided with update from CEIOPS and others would have more room of interpretation to determine or update their risk free rate term structure.	
512.	German Insurance Association – Gesamtverb and der D	3.52.	See comments to Para 3.35, 3.36 and 3.20	Noted.
513.	Groupe Consultatif	3.52.	The Groupe Consultatif believes that the relevant structure should be made available continuously i.e. on a daily basis for sake of financial stability.	Not agreed. It is not feasible for CEIOPS to publish rates on a daily basis.
514.	Investment & Life Assurance Group (ILAG)	3.52.	We would remind CEIOPS that firms' year ends may not be at a quarter end. The rates must be capable of being derived on a market consistent basis at any working day to ensure liabilities are valued at a consistent basis to assets. If CEIOPS publishes rates, it will need to do so at least daily.	Not agreed. It is not feasible for CEIOPS to publish rates on a daily basis.
515.	KPMG ELLP	3.52.	We agree that if CEIOPS decides to mandate a risk free term structure then the full methodology should be provided and the	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			data should be readily accessible. We would add that this needs to be a very long maturity term structure (of the order of 120 years) to ensure all business across Europe had a long term rate. Many firms will require a term structure at more regular intervals to conduct risk mitigation and solvency monitoring so a more frequent curve should be provided if possible. The publication of the official term structure will also need to be very prompt (including each 1st January) in order to help (re)insurance undertakings to meet tight reporting timescales. ESG providers who currently provide this service frequently need to meet this timescale. Where ESG providers need to rely on external non-commercial organisations to provide an official term structure, delays are often encountered because non-commercial enterprises lack a service level agreement between the term structure provider and the industry they are serving. One solution would be to set up a single European wide authority with a mandate to deliver timely risk free term structures to a prescribed methodology.	
516.	Legal & General Group	3.52.	Insurance firms do not only have reporting dates that coincide with quarter ends and therefore daily risk-free interest rate term structures are needed to meet this objective.	Not agreed. It is not feasible for CEIOPS to publish rates on a daily basis.
517.	Lloyd's	3.52.	As well as publishing the interest rate term structure for the EEA currencies each quarter, we request that this is also published for major non-EEA currencies, especially US Dollar (USD), Japanese Yen (JPY) and Canadian Dollar (CAD).	Noted.
518.	OAC plc	3.52.	Insurance firms do not only have reporting dates that coincide with only quarter ends. It is assumed that the intention of providing the risk-free interest rate term structure is that these rates and only these rates are used for reporting purposes. Given the different reporting dates of firms and that they do not all coincide with	Not agreed. It is not feasible for CEIOPS to publish rates on a daily basis.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			quarter or month ends then daily risk-free interest rate term structures to meet this objective.	
519.	AFA	3.53.	f) Consistency: the rates should be consistent with how the liabilities are indexed Liability cash flows indexed with cpi should be discounted with the term structure of index-linked bonds whereas cash flows not indexed should be discounted with the term structure of nominal bonds.	Not agreed. The risk-free rate should not depend on the nature of the guarantee underlying the obligation.
520.	Association of British Insurers	3.53.	We disagree with the criteria "no credit risk" if that precludes an appropriate adjustment for credit risk. Instead we believe the criteria should be "the (adjusted) discount rate should exclude any reward for credit risk"	Noted.
521.	Association of Danish Mortgage Banks (Realkreditrådet)	3.53.	A certain degree of flexibility in the choice of term structure with regard to liability measurement is very important to promote financial stability. It should be possible that the applied term structure to a certain degree 1) mirrors the asset composition of risk averse insurance companies and 2) is tradeable, liquid and with no substantial credit risk. In Denmark this implies a term structure which also includes covered bond instruments. This is due to the fact that the government yield curve is insufficient for maturities longer than 10 years. This is not the case for the covered bond yield curve, which is at the same time highly liquid. Furthermore the L&P sector in Denmark possesses large holdings of Danish mortgage bonds. This is a natural consequence of these circumstances: 1) There is a natural match between the L&Ps' obligations and the Danish mortgage bonds (long maturities, same currency and virtually no credit risk). 2) The market for Danish government bonds - as another	Not agreed. The risk-free term structure should be independent from the assets of the undertaking.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			alternative investment for L&P companies - is rather small: Only one third the size of the market for Danish mortgage bonds. 3) Investments in European covered bonds will cause currency risk because Denmark is not part of the euro.	
522.			Confidential comment deleted.	
523.	CEA, ECO-SLV-09-434	3.53.	See comments to Para 3.3 to 3.21 inclusive.	See resolutions there.
524.	CRO Forum	3.53.	The crucial point here is that no own credit risk should be considered when determining the risk-free interest rate.	Not agreed. The risk-free rate is required to be free of credit risk.
525.	Danish Insurance Association	3.53.	CEIOPS should allow for a choice of term structure which allows for all criteria to fulfilled to a significant extent. Instead, CEIOPS is overly reliant on the no credit risk criteria.	Not agreed. The no credit risk criterion is a direct consequence of the Level 1 text.
526.	Deloitte Touche Tohmatsu	3.53.	We note the difficulty in aligning with accounting principles that do not yet exist consistently across Europe.	Noted.
527.	Dutch Actuarial Society – Actuariële Genootschap (	3.53.	Move to before 3.48. Combine d) and e) into a single principle.	Noted.
528.	FFSA	3.53.	Risk-free rate criteria : CEIOPS defines the following five criteria to be ideally met by the relevant risk-free rate term structure: no credit risk, realism, reliability, high liquidity, no technical bias. According to this CP, the government bond structure constructed by ECB meets all criteria	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			(3.34). Appendix C compares the ability of government bonds and swaps rate to meet the criteria for UK pounds sterling and concludes in retaining swap curve less adjustment for credit risk. Furthermore, this emphasis on credit swap curve seems overestimated as the mitigation of this risk is developed via collateralisation. In Economic Scenario Generator, it is important to calibrate volatility to available price of option, The absence of options in ECB is likely to be an issue to value liabilities time value of options. FFSA would like the CEIOPS to define how the criteria would be applied to adjust financial instruments (option 5) to derive the risk-free rate term structure. Regarding criteria, satisfying (b) realism and no technical bias(e) might be difficult to achieve : if there is a big pressure on one particular maturity and that the corresponding rate is adjusted, it will be very difficult to find any replicating asset on the capital markets. Therefore FFSA believes market date should be adjusted in very limited cases. FFSA believes that swap curve (option 1) fits the majority of criteria. FFSA strongly disagrees with CEIOPS impact assessment which considers Swap rates are poor to enhance policyholders' protection. SWAP rates are provided with implied volatilities which are used to measure time value of options and guarantees, whereas this is not the case for government bonds. Monitoring the time value of options and guarantees is crucial to insure policyholders' protection as a whole and anticipate potential risks which are linked to this time value.	Not agreed. Swap rates are not risk-free.
529.	German Insurance Association – Gesamtverb	3.53.	See comments to Para 3.3 to 3.21 inclusive.	See resolutions there.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	and der D			
530.	Groupe Consultatif	3.53.	We propose an additional criterion: liabilities and replicating assets should be valued on a consistent basis. (Further discussions see 3.3)	Not agreed. Replicating assets may not be valued on a risk-free basis.
531.	Just Retirement Limited	3.53.	In practice, there is no term structure that meets all of the criteria over the term of long-term insurance liabilities. Financial markets do not regard insurers as risk-free, as evidenced by the prices at which subordinated debt issued by insurers trades. It is considerably more important to use a term structure which works in practice and avoids pro-cyclicality than to dwell too strongly on credit risk.	Not agreed. The no credit risk criterion is a direct consequence of the Level 1 text.
532.	KPMG ELLP	3.53.	(a) We would highlight that instruments with no credit risk do not exist as every issuing institution has some degree of credit risk - all that varies is the degree of risk. The definition of credit risk also needs to be carefully considered. Does this, for example, include tax / legislative changes by the issuer of the debt that reduce the net cash-flows? (b) We agree that rates should be earnable, but please see comment (a) above on net cash-flows. If there is some doubt over the ability to earn the swap rates due to credit risk, then this could be treated by an addition to the SCR default risk module consistent with the credit risk that is being taken by the (re)insurance undertakings. (c) We agree with the sentiment that a rate should be reliable. However it should be borne in mind that in times of extreme crisis there is likely to be flexibility in the solvency regime (e.g. the Pillar 2 dampener) to avoid pro-cyclical feedback loops. Therefore a high degree of accuracy in times of crisis is, perhaps, spurious accuracy. (d) We agree that high liquidity is a desirable feature to avoid	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			spurious balance sheet volatility but note that liquidity is not a permanent feature of any market – especially at the durations of interest to (re)insurance undertakings. Therefore we would suggest that some flexibility is built into these definitions. (e) As discussed above government bond markets are subject to technical bias and the proposal for a common French / German dominated Euro-zone term structure is likely to increase the technical bias further	
533.	Legal & General Group	3.53.	The risk free interest rate term structure is missing the criterion that it needs to be set consistent with achieving a solvency confidence level of 99.5% over a one-year period. The initial sentence in the paragraph should be amended to read as follows: “The relevant risk-free interest rate term structure should be consistent with achieving a solvency confidence interval of 99.5% and would incorporate the following criteria (“risk-free rate criteria”):” Point (a) This should be amended as follows: “(a) No credit risk: the rates should be free of credit risk but may recognise liquidity premia as appropriate.”	Not agreed. The discount rate should not be based on the SCR calibration objective.
534.	Lloyd’s	3.53.	We agree this is an ideal requirement.	Noted.
535.	Munich RE	3.53.	The crucial point here is that no own credit risk should be considered when determining the risk-free interest rate.	Not agreed. The risk-free rate is required to be free of credit risk.
536.	OAC plc	3.53.	The risk free rate interest rate term structure is missing the criteria that it is set consistent with achieving a solvency confidence level of 99.5% over a one-year period. The paragraph only refers to “ideally meeting the following criteria”.	Not agreed. The discount rate should not be based on the SCR calibration objective.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			Add in the first line after should "be consistent with achieving a solvency confidence level of 99.5% and would incorporate the following principles. Delete the "ideally to criteria" Add an extra criterion (e) the rate should be related to market observable data as far as is possible.	
537.	Prof. Antoon Pelsser, Maastricht University	3.53.	Move to before 3.48. Combine d) and e) into a single principle.	Noted.
538.	ROAM – Draft V2	3.53.	Risk-free rate criteria : CEIOPS defines the following five criteria to be ideally met by the relevant risk-free rate term structure: no credit risk, realism, reliability, high liquidity, no technical bias. According to this CP, the government bond structure constructed by ECB meets all criteria (3.34). Appendix C compares the ability of government bonds and swaps rate to meet the criteria for UK pounds sterling and concludes in retaining swap curve less adjustment for credit risk. Furthermore, this emphasis on the credit swap curve seems overestimated as the mitigation of this risk is developed via collateralisation. In Economic Scenario Generator, it is important to calibrate volatility to available price of option; The absence of options in ECB is likely to be an issue to value liabilities time value of options. ROAM would like CEIOPS to define how the criteria would be applied to adjust financial instruments (option 5) to derive the risk-free rate term structure. Regarding criteria, satisfying (b) realism and no technical bias (e) might be difficult to achieve: if there is a big pressure on one particular maturity and the corresponding rate is adjusted, it will be very difficult to find any replicating asset on	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			the capital markets. Therefore ROAM believes market date should be adjusted in very limited cases. ROAM believes that the swap curve (option 1) fits the majority of criteria. ROAM strongly disagrees with CEIOPS impact assessment which considers Swap rates are poor to enhance policyholders' protection. SWAP rates are provided with implied volatilities which are used to measure time value of options and guarantees, whereas this is not the case for government bonds. Monitoring the time value of options and guarantees is crucial to insure policyholders' protection as a whole and anticipate potential risks which are linked to this time value.	Not agreed. Swap rates are not risk-free.
539.	Association of British Insurers	3.54.	We completely disagree with this proposal. It is based on a number of incorrect premises. See 3.8 and 3.26 and general comments	See resolutions there.
540.	Association of Danish Mortgage Banks (Realkreditrådet)	3.54.	See 3.53	See resolutions there.
541.	ASSOCIATION OF FRIENDLY SOCIETIES (AFS)	3.54.	We believe swaps meet all the criteria and are less prone to technical issues.	Not agreed. Swap rates are not risk-free.
542.			Confidential comment deleted.	
543.	AVOE – Aktuarvereinigung	3.54.	We suggest to consider as a suitable compromise taking (collateralized) swap rates (if available) and allowing for government rates in markets where these are not available. This	Not agreed. Swap rates are not risk-free.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	Österreichs – Actuarial		would avoid creating too much demand for AAA graded government bonds leading to lower interest rates in the long run.	
544.	CEA, ECO-SLV-09-434	3.54.	We strongly disagree with this proposal - See comments to Para 3.3 to 3.21 inclusive.	See resolutions there.
545.	CRO Forum	3.54.	We advocate the swap curve (plus illiquidity premium) as the best proxy for the risk-free interest rate curve. Government bonds are considered by CEIOPS as the benchmark for risk free rates based on the criteria set at 3.53. One could argue that also government bonds are subject to periods of liquidity issues (e.g. Dec 30th 2008 and Feb 28th 2009) and technical bias. Also recent CDS data can be used to show that government bonds are not free from credit risk. Moreover as explained in comment 3.7 we do not agree with the statement that swap are not credit risk free. However, if they contain credit risk this will be immaterial. We believe that there is no argument that govt bonds is more right than swap from a credit risk perspective.	Not agreed. Swap rates are not risk-free.
546.	Danish Insurance Association	3.54.	Swap rates fulfil many of the criteria listed in 3.53 and may entail a better package of all criteria than AAA rated government bonds. Therefore, the possibility to base the term structure on swap rates and rates on other financial instruments should not just be rejected. It should be taking into consideration, that if swaps rates are being replaced with government bond rates it will force life insurance companies to make extremely long credit commitment of a length of 30-40 years.	Not agreed. Swap rates are not risk-free.
547.	Dutch Actuarial	3.54.	Change to: Government bonds rates of AAA rated governments should be	Not agreed. Swap rates are not risk-free.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	Society – Actuarieel Genootschap (		considered as the benchmark for credit risk-free rates. Swap agreements can also be an appropriate basis for discounting technical provisions. Although swap agreements are not perfectly risk-free, they have the desirable characteristic that market prices are available for very long maturities which are relevant for discounting life insurance and pension liabilities.	
548.	European Insurance CFO Forum	3.54.	The CFO Forum fundamentally disagrees with the proposal to use risk-free interest rates based on AAA government bonds. The key arguments against the use of AAA government bonds are: R Using AAA government bonds would lead to price dislocation given limited liquidity; R A number of jurisdictions do not have AAA government bonds; R Additional guidance would be required in order to choose between multiple government bond curves for currencies other than the Euro. The CFO Forum believes that swaps present a better basis for determining the appropriate interest rate for discounting insurance liabilities for the following reasons: R Swaps have minimal credit risk due to the requirement for collateral and being exchange traded and settled through a clearing bank; R Swaps are margin transactions so there is significant liquidity in the swap market, even when capital markets are constrained. Swap markets are deep and liquid, more so than	Not agreed. According to the three stage approach government bonds should only be used given sufficient liquidity. This is addressed in the three stage approach. See definition of AAA-ECB yield curve. Swaps are not risk-free.

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
		government bond markets; R The use of swaps is consistent with the measurement of derivatives that are recognised on insurance balance sheets; R Swaps do not suffer from systematic distortions due to supply/demand or regulatory constraints; R Swaps cover a wider spectrum of future durations providing a better model for the yield curve when considering very long term insurance liabilities in some countries; R Swaps are used for MCEV. Consistency with this work stream is also desirable as the MCEV framework is also based on economic principles. Where the liabilities are illiquid, we also believe that the risk-free interest rate should be increased to include an illiquidity premium, as per our comments in paragraph 3.30.	
549.	FFSA	3.54. Use of government bonds : CEIOPS says that: AAA government bonds rate should be used as the benchmark for credit risk-free rate and rejects the use of unadjusted swap rates as swaps are not risk-free. FFSA underlines that some arguments used in Appendix C such as supply and demand effect for government bonds (C.31) are not specific to UK. Therefore, FFSA considers that the use of swap rates rather than government bonds is more appropriate for all currencies including Euro and likely to insure a better consistency between countries. Moreover, contrary to ECB rate curve, the swap curve has an economical sense as it is used for market exchanges. The access to this curve is simple and transparent, as the ECB curve is only a theoretical concept, and will drive undertakings dependant of ECB	Not agreed. Swap rates are not risk-free.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			for their solvency calculations.	
550.	German Insurance Association – Gesamtverb and der D	3.54.	We strongly disagree with this proposal - See comments to Para 3.3 to 3.21 inclusive.	See resolutions there.
551.	Groupe Consultatif	3.54.	We strongly disagree for reasons stated above CEIOPS’s proposal would oblige insurers increasingly to back their liabilities with ‘AAA-rated’ government bonds. Only a minority of EU governments are currently ‘AAA-rated’. In the eurozone this is essentially Germany and France only. Possible consequences of this policy are: Insurers are likely to sell domestic government bonds in non ‘AAA-rated countries’ (e.g. Italy, Spain, Greece, Poland, Ireland, etc.). This affects the funding of these governments. Because of high volatility against the valuation of liabilities via ‘AAA’ government bonds insurers are likely to reduce investments in industry by reducing holdings of corporate bonds. This will reduce supply and increase the cost of capital to industry. France and Germany will see government bond prices artificially inflated: this will push down yield curves beyond their proper equilibrium and result in an inappropriate reduction in discount rates, forcing companies to increase technical provisions across the board beyond an economic level, building in excessive prudence, and so increasing the price of insurance. In particular, a downgrade of Germany or France will cause considerable market turbulence. Trying to force insurers to use only ‘AAA-government’ bonds would introduce significant distortions and would apply a form of “tax” on	Not agreed. There is no obligation to hold AAA government bonds.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			the holding of any other asset, whether high quality corporate bonds or even government bonds in the insurer's own country (when the rating is below AAA). This "tax" would be over and above any adjustment for credit risk and would in part reflect the increased volatility introduced by the CP40 requirement to match all liabilities in essence to only two EUR-countries whose governments bonds are 'AAA-rated'. This mismatch would however be unavoidable as the total amount of insurance liabilities would exceed the supply of these bonds available to insurers. In fact AAA-government bonds are not risk free. Their credit risk is negligible, but other aspects have to be taken into account (limited liquidity in particular for long maturities, technical bias). Hence a more flexible approach is needed depending on the swap based risk-free term structure, which has a slightly higher credit risk, but advantages with respect to liquidity and technical bias.	
552.	Investment & Life Assurance Group (ILAG)	3.54.	We believe swaps meet all the criteria and are less prone to technical issues.	Not agreed. Swap rates are not risk-free.
553.	Ireland's Solvency 2 Group, excluding representa	3.54.	The proposal to adopt a single AAA-government bond term structure for EUR-denominated liabilities may have implications for demand from (re)insurance companies for non-AAA EUR government debt. (Re)insurers in Eurozone countries whose government debt is not AAA-rated could be expected to sell their holdings of domestic government debt and buy bonds of AAA-rated countries instead, as these assets will better match their liabilities. Furthermore, any future downgrades of countries that are currently AAA-rated could trigger such behaviour as a consequence of the downgrade.	Not agreed. There is no obligation to hold AAA government bond rates.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
554.	Just Retirement Limited	3.54.	We support the discussion in Appendix C and its conclusion that, for GBP liabilities, swaps (as adjusted for the small degree of credit risk) are preferable to UK government bonds, for liquid liabilities. However we believe that the rationale for using this method (ie swaps less an adjustment for credit risk) stands independently of whether or not there are technical biases (or other shortcomings) in the UK government bond yield curve, and this should be recognised in the Level 2 rules. Illiquid liabilities would need an illiquidity premium adjustment to swap rates, as discussed above.	Noted.
555.	KPMG ELLP	3.54.	As mentioned in 3.53 risk free rates do not exist, there are just differing degrees of credit risk. Also as mentioned in 3.53 it is not clear if credit risk includes a reduction in net cash-flows due to tax / legislative changes of the issuing government. It is likely that mandating AAA rated bonds will cause significant issues for countries whose domestic bonds are lower rated. At the time of writing three Euro-zone countries had government bonds rated at AA. Choosing the risk free rate to be based on AAA government bonds will create a basis risk between the market instruments and transactions used for hedging and the value of liabilities. This will create an extra capital requirement for the (re)insurance undertakings and reduce the incentive to hedge risks that the (re)insurance undertakings does not want to retain. Choosing the risk free rate to be based on AAA government bonds is also likely to create a pro-cyclical element to the technical provision calculation. This is referred to as the "flight to quality" effect (as mentioned in the Annex analysis by Sweden and UK in this Consultation Paper).	Not agreed. The Level 1 text requires the use of risk-free rates. Not agreed. Such an issue could not be identified. Not agreed. It is unclear what the notion of basis risk refers to. Not agreed.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			While we appreciate a lot of the good work and analysis done by rating agencies we do not believe that ratings should be mandated into regulation.	Not agreed. There seems to be no alternative to the use of ratings.
556.	Legal & General Group	3.54.	For liquid liabilities, we do not agree that government bond rates should be used to the exclusion of swap rates. We consider that neither is entirely risk free and that swap rates have significant advantages. For illiquid liabilities, we consider that the risk free rate should include allowance for the liquidity premium.	Noted.
557.	Munich RE	3.54.	We advocate the swap curve as the best proxy for the risk-free interest rate curve. A liquidity premium should be taken into account over the swap rate where appropriate.	Not agreed. Swap rates are not risk-free.
558.	OAC plc	3.54.		
559.	Prof. Antoon Pelsser, Maastricht University	3.54.	Change to: Government bonds rates of AAA rated governments should be considered as the benchmark for credit risk-free rates. Swap agreements can also be an appropriate basis for discounting technical provisions. Although swap agreements are not perfectly risk-free, they have the desirable characteristic that market prices are available for very long maturities which are relevant for discounting life insurance and pension liabilities.	Noted.
560.	ROAM – Draft V2	3.54.	Use of government bonds : CEIOPS says that: AAA government bonds rate should be used as the benchmark for credit risk-free rate and rejects the use of unadjusted swap rates as swaps are not risk-free. ROAM underlines that some arguments used in Appendix C such as supply and demand effect for government bonds (C.31) are not	Not agreed. There seems to be no technical bias in the ECB yield curve.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			specific to UK. Therefore, ROAM considers that the use of swap rates rather than government bonds is more appropriate for all currencies including Euro and likely to insure a better consistency between countries. Moreover, contrary to the ECB rate curve, the swap curve has an economical sense as it is used for market exchanges. The access to this curve is simple and transparent, as the ECB curve is only a theoretical concept, and will make undertakings dependant of ECB for their solvency calculations.	Not agreed. Government bonds are not just a theoretical concept but a relevant part of undertaking's investments.
561.	UNESPA (Association of Spanish Insurers)	3.54.	We strongly disagree with this proposal. In our opinion the swap curve is the closest concept to the risk-free rate. Let's start assuming that all curves have a certain credit risk, so the basic issue is to determine the best approach to find the "risk-free rate" curve. Under this premise, we believe the swap curve is the most similar concept to the risk-free rate curve for the following reasons: - The swap curve is an unfunded curve, so there is no exchange of notional. Therefore, the only risk in the operation is the present value of the difference between the interest rates bought and sold in the operation (fix and floating). On top of that, the swap counterparties use to have settlement programs which reduces even more the possible credit risk. On the other hand, we should not be confused by the fact that the swap curve is constructed by the aggregation of the difference bids and offers issued of the participant banks, and the fact that the banks themselves are having a risk and a rating. When it is said a certain bank is rated XXX, we are referring to its debt issues, senior or subordinated, but never to its unfunded positions, such as the	Not agreed. Swap rates are not risk-free.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			swap curve or any others. - However it could be though in a first approach, government curves present credit risk. In fact, history has shown the default of some countries, which in addition is reflected in the existence of a CDS market over governments. We would also like to mention that if a government defaults, the unpaid amounts equals the nominal invested plus the difference between the current swap rate (fix) and the IRR on the defaulted bond (which is mathematically equivalent to the previous swap rate differential). - If we want to adapt our standards to market value, we should accept the market conventions, than as mentioned above, include the using of the swap curve in the net present value calculations and the existence of credit risk in the government bonds. (Article 74.1 a) of the Directive). In the current situation, with the long end of the swap curve presenting lower values than the government bond curve, it could be interpreted than the market perceives a higher risk in government bonds than in the swap curve. - Regarding to what was stated in the CP, it is accepted the collateral agreements at Lehman Brothers Inc. have performed relatively well.	
562.	XL Capital Ltd	3.54.	"Government bond rates of AAA rated governments should be considered as the benchmark for credit risk-free rates. Swap rates are not credit risk-free and for this reason unadjusted swap rates should not be used to discount technical provisions." We believe that CEIOPS should allow flexibility to use swap rates adjusted for credit risk.	Noted. This is possible under stage three of the three stage approach.
563.	Association of British	3.55.	See 3.8 and 3.26	See resolutions there.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	Insurers			
564.	ASSOCIATION OF FRIENDLY SOCIETIES (AFS)	3.55.	We believe that swaps should be accepted at the same point as government bonds	Not agreed. Swap rates are not risk-free.
565.			Confidential comment deleted.	
566.	CEA, ECO-SLV-09-434	3.55.	See comments to Para 3.26.	See resolutions there.
567.	Dutch Actuarial Society – Actuariële Genootschap (	3.55.	Delete: not principle based.	Noted.
568.	European Insurance CFO Forum	3.55.	Comments in 3.48 and 3.54 are also relevant here.	See resolutions there.
569.	FFSA	3.55.	CEIOPS presents a three stage approach to derive the risk-free rate curve from government bonds. FFSA considers that the approach remains theoretical and the CP does not give practical solutions to demonstrate how this could practically work and how each approach will be validated by CEIOPS.	Noted.
570.	German Insurance Association	3.55.	See comments to Para 3.26	See resolutions there.

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	- Gesamtverb and der D			
571.	Groupe Consultatif	3.55.	We strongly disagree for reasons stated above The aspect of market turbulence should be included, see 3.9, 3.31 We do not believe that government bonds should be used as the unique base for determining the risk free interest rate term structure. Using such a definition creates significant basis risks and therefore systematic risk for the supervisor system that does not reflect the economic realities of all insurance contracts. It is important that when taken together the technical provisions and capital requirements reflect the underlying economic and contractual risks of the insurance contracts. It is important that the regulatory system does not create risks that then require capital to be held as the cost will be borne by the policyholder and they derive no benefit. For example for a whole of life annuity with no surrender value options ever requiring technical provisions and capital to be held based effectively on a notional surrender value calculated on government bond interest rates is unreasonable. This is a considerable adverse change compared with Directive 2002/83/EC. The definition of risk free interest rate is therefore an adverse and retrograde step for annuities without surrender values compared with the current regime.	See resolutions there. Not agreed. The notion of basis risk is unclear. Not agreed. Discounting with a risk-free rate is required in the Level 1 text.
572.	Investment & Life Assurance Group (ILAG)	3.55.	We believe that swaps should be accepted at the same point as government bonds	Not agreed. Swap rates are not risk free.
573.	KPMG ELLP	3.55.	If government rates are to be used this seems a sensible approach.	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
574.	Legal & General Group	3.55.	We do not believe that government bonds should be used as the unique base for determining the risk free interest rate term structure. Using such a definition creates significant basis risks and therefore systematic risk for the supervisory system that does not reflect the economic realities of all insurance contracts. It is important that when taken together the technical provisions and capital requirements reflect the underlying economic and contractual risks of the insurance contracts. It is important that the regulatory system does not create risks that then require capital to be held as the cost will be borne by the policyholder and they derive no benefit. For example, for a whole of life annuity with no surrender value options, requiring technical provisions and capital to be held based on a notional surrender value calculated on government bond interest rates is unreasonable. This is a considerable adverse change compared with Directive 2002/83/EC. The definition of risk free interest rate is therefore an adverse and retrograde step for annuities without surrender values compared with the current regime. Also applies to sections 3.56 – 3.59	Not agreed. The notion of basis risk is unclear. Not agreed. Discounting with a risk-free rate is required in the Level 1 text.
575.	Lloyd's	3.55.	For the currencies of minor economies outside the EEA it may not be feasible or practical to apply stages 2 and 3 accurately. For example, for stage 3 'other financial instruments' may not readily be available. Clearly, the principle of proportionality should apply, with firms having discretion as to the extent they go beyond the first stage (otherwise stages 2 and 3 could result in a significant amount of work with negligible impact on the overall result). Proportionality should take into account the size of the minor currency liabilities in relation to the rest of the portfolio and also the duration of the liabilities (the shorter the duration the reduced impact of discounting on the liabilities).	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
576.	OAC plc	3.55.	We do not believe that government bonds should be used as the unique base for determining the risk free interest rate term structure. Using such a definition creates significant basis risks and therefore systematic risk for the supervisor system that does not reflect the economic realities of all insurance contracts. It is important that when taken together the technical provisions and capital requirements reflect the underlying economic and contractual risks of the insurance contracts. It is important that the regulatory system does not create risks that then require additional capital to be held as the cost will be borne by the policyholder and they derive no benefit. For example for a whole of life annuity with no surrender value options ever requiring technical provisions and capital to be held based effectively on a notional surrender value calculated on government bond interest rates is unreasonable. This is a considerable adverse change compared with Directive 2002/83/EC. The definition of risk free interest rate is therefore an adverse and retrograde step for annuities without surrender values compared with the current regime.	Not agreed. The notion of basis risk is unclear. Not agreed. Discounting with a risk-free rate is required in the Level 1 text.
577.	PricewaterhouseCoopers LLP	3.55.	See comments under 3.26	See resolutions there.
578.	Prof. Antoon Pelsser, Maastricht University	3.55.	Delete: not principle based.	Noted.
579.	RBS Insurance	3.55.	Will need suitable specified adjustments where governments not 'AAA' rated, assumed centrally.	Noted. This is inline with the CP.
580.	ROAM – Draft V2	3.55.	CEIOPS presents a three stage approach to derive the risk-free rate curve from government bonds.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			ROAM considers that the approach remains theoretical and the CP does not give practical solutions to demonstrate how this could practically work and how each approach will be validated by CEIOPS.	
581.	UNESPA (Association of Spanish Insurers)	3.55.	See comments to Para 3.54	See resolutions there.
582.	Uniqa	3.55.	An explicit methodology or guideline how to determine the adjustments for the 'second stage' should be provided by CEIOPS. Especialy for interest rates in Eastern European countries there should be a clear methodology and guidance. Because for some currencies there might be no sufficient Government rates and Swap rates, the ratings are far away from AAA and markets are not liquid or deep.	Noted.
583.	Association of British Insurers	3.56.	See 3.8 and 3.26 and general comments	See resolutions there.
584.			Confidential comment deleted.	
585.	BARRIE & HIBBERT	3.56.	See comment under 3.47.	See resolutions there.
586.	Dutch Actuarial Society – Actuarieel Genootschap (	3.56.	Delete: not principle based.	Noted.
587.	FFSA	3.56.	How to derive risk-free rate for different maturities	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			CEIOPS explains that this three stage approach could apply to long term maturities. The CP also explores extrapolating methods for long term maturities (3.38 to 3.47) without really describing how the three stage approach in particular how it can be demonstrated that the second stage approach: adjusting government bonds shall be assessed before moving to third stage approach. FFSA thinks that the use of mix of government bonds and other financial instruments following this approach by maturity could lead to a very complex situation.	
588.	Groupe Consultatif	3.56.	We strongly disagree for reasons stated above	See resolutions there.
589.	KPMG ELLP	3.56.	If government rates are to be used this seems a sensible approach.	Noted.
590.	Legal & General Group	3.56.	As per 3.55	See resolutions there.
591.	Lloyd's	3.56.	We agree.	Noted.
592.	OAC plc	3.56.	As per 3.55	See resolutions there.
593.	Prof. Antoon Pelsser, Maastricht University	3.56.	Delete: not principle based.	Noted.
594.	ROAM – Draft V2	3.56.	How to derive risk-free rate for different maturities CEIOPS explains that this three stage approach could apply to long term maturities. The CP also explores extrapolating methods for long term maturities (3.38 to 3.47) without really describing how the three stage approach, in particular how it can be demonstrated that the second stage approach: adjusting government bonds shall	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			be assessed before moving to third stage approach. ROAM thinks that the use of a mix of government bonds and other financial instruments following this approach by maturity could lead to a very complex situation.	
595.	UNESPA (Association of Spanish Insurers)	3.56.	See comments to Para 3.54	See resolutions there.
596.	CEA, ECO-SLV-09-434	3.57.	See comments to Para 3.28.	See resolutions there.
597.	Dutch Actuarial Society – Actuariel Genootschap (	3.57.	A process should ensure at Level 3 that the relevant risk-free interest rate term structures for the different currencies meet in the best possible way the risk-free rate criteria. The curve chosen should be explained and justified by Member States and revised regularly.	Noted.
598.	European Insurance CFO Forum	3.57.	Comments in 3.38 are also relevant here. Is this paragraph referring to Level 3 supervisory guidance or “Third stage” as per paragraph 3.55? The CFO Forum highlights that all guidance on interest rate term structures should be set in Level 2 implementing measures.	Noted.
599.	FFSA	3.57.	Checking methodology : CEIOPS says: if unadjusted government bonds are not used to derive risk-free rate, it should be explained and justified by the Member States and revised regularly. Level 3 should describe the	Not agreed. It is neither necessary nor practicable possible to specify all details on Level 2.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			process to check that risk-free rate meet the best possible way the benchmark of risk-free government rates. FFSA would like all these elements to be defined in level 2.	
600.	German Insurance Association – Gesamtverb and der D	3.57.	See comments to Para 3.28	See resolutions there.
601.	Groupe Consultatif	3.57.	We strongly disagree for reasons stated above The process has to be defined in such a way that a level playing field for the insurance companies exists and arbitrage between countries is excluded.	See resolutions there.
602.	KPMG ELLP	3.57.	If government rates are to be used this seems a sensible approach.	Noted.
603.	Legal & General Group	3.57.	As per 3.55	See resolutions there.
604.	OAC plc	3.57.	As per 3.55	See resolutions there.
605.	PricewaterhouseCoopers LLP	3.57.	See comments under 3.28	See resolutions there.
606.	Prof. Antoon Pelsser, Maastricht University	3.57.	A process should ensure at Level 3 that the relevant risk-free interest rate term structures for the different currencies meet in the best possible way the risk-free rate criteria. The curve chosen should be explained and justified by Member States and revised regularly.	Noted.
607.	ROAM –	3.57.	Checking methodology :	Not agreed. It is neither

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09				
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	Draft V2		CEIOPS says: if unadjusted government bonds were not used to derive risk-free rate, it should be explained and justified by the Member States and revised regularly. CEIOPS also says that Level 3 should describe the process to check that the risk-free rate meets in the best possible way the benchmark of risk-free government rates. ROAM would like all these elements to be defined in level 2.	necessary nor parcticabli possible to specify all details on Level 2.
608.	UNESPA (Association of Spanish Insurers)	3.57.	See comments to Para 3.54	See resolutions there.
609.	ACA – ASSOCIATION DES COMPAGNIES D'ASSURANCES DU	3.58.	A yield curve published by a European instance is welcome. But as commented under 3.6. we consider that under some circumstances the ECB's yield curve doesn't reflect risk free rates.	See resolutions there.
610.	Association of British Insurers	3.58.	We completely disagree with this proposal. It is based on a number of incorrect premises. See 3.8 and 3.26 and general comments	See resolutions there.
611.	CEA, ECO-SLV-09-434	3.58.	We strongly disagree with this proposal - See comments to Para 3.3 to 3.21 inclusive.	See resolutions there.
612.	CRO Forum	3.58.	CEIOPS proposes criteria for Euro government rate which is heavily based on the French and the German government bonds and can prove to be very onerous for other European countries.	

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			The effects of such a policy can be; R Insurers likely to sell domestic government bonds in non 'AAA-rated countries' (e.g. Italy, Spain, Greece, Poland, Ireland, etc.) making it harder for these governments to borrow and increasing the price they must pay to issue debt. R France and Germany will see government bond prices artificially inflated: this will push down yield curves beyond their proper equilibrium and result in an inappropriate reduction in discount rates, forcing companies to increase technical provisions across the board beyond an economic level, building in excessive prudence, and so increasing the price of insurance. This is also inconsistent with the principles based approach advocated by the directive. Here, the swap rate which is unique in the Euro brings pragmatic advantages.	Not agreed. There is no incentive to sell non-AAA rated bonds nor to buy AAA rated bonds.
613.	Dutch Actuarial Society – Actuariel Genootschap (	3.58.	Delete: not principle based.	Noted.
614.	FFSA	3.58.	Risk free rate yield curve for euro CEIOPS says: the ECB government yield curve should be used as the relevant risk-free rate term structure for euro. FFSA disagrees on treating the determination of risk free rate yield curve in different level: euro currency at level 2 and other currencies at level 3. ECB AAA government yield curve is based on an implicit ponderation of the AAA of each country in the Euro zone this could	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			lead to "benchmark issues" because of the size, liquidity and market depth in some of the countries of the Euro zone ECB AAA government bond yield curve is interpolated with Nelson Siegel model which 1) does not allow a perfect fit of all the points on the curve and 2) might not be consistent with the methodology finally required by the CEIOPS for any interpolation of the risk-free yield curve Furthermore FFSA is not convinced that using ECB government yield curve for euro addresses the consistency between currencies and believes that Swap curve (option 1) is more likely to address this matter. Moreover, if a risk free interest yield curve is defined for a given currency at Level 2 (and FFSA supports this), it has to be defined for all currencies to avoid distortions.	
615.			Confidential comment deleted.	
616.	German Insurance Association – Gesamtverb and der D	3.58.	We strongly disagree with this proposal - See comments to Para 3.3 to 3.21 inclusive.	See resolutions there.
617.	GROUPAMA	3.58.	Groupama is in favour of using the Swap Rate Curve (CEIOPS' option 1) as the reference for the risk free rate curve. Indeed, contrary to the ECB AAA-rated government curve, the swap curve: - is read directly from the market at all times. The ECB government curve is the result of a questionable methodology, and prevents participants from being able to get this major input directly from the market for solvency calculations	Not agreed. Swap rates are not risk-free.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			- has an economic sense because of the day-to-day use of this reference on the market. - It is easy to obtain implied volatilities for the swap curve, whereas it is impossible to have implied volatilities on the ECB curve, as it is not used for market transactions.	
618.	Groupe Consultatif	3.58.	We strongly disagree for reasons stated above In our view a blend of bond and swap rates are the more appropriate basis for the risk free term structure, see 3.22	Not agreed. Swap rates are not risk-free.
619.	KPMG ELLP	3.58.	We agree that the ECB curve is a useful, objective curve that is published almost daily. However we are not sure it meets the earnable criteria. Our understanding is that the AAA ECB rate is derived by bucketing all AAA bonds into one of five maturity buckets and then taking an average duration and yield for all the bonds in that bucket. The only document referenced with the ECB yield curve on the ECB Yield Curve page cited at the bottom of page 11 of CP40 doesn't explain which bonds are currently in use, where the latest list can be found and how the averaging takes place. A smooth curve is then fitted to the five data points. Therefore the rates are not necessarily earnable as the curve has not been designed to fit all the bonds. Rather it has been designed to fit 5 "averaged" bonds. The technical reference document on the ECB website refers to EuroMTS suggesting that the underlying bonds for one of the EuroMTS Euro Government Bond indices, but no reference is provided in the CP40 document or in the technical paper on the ECB website. Considering the methodology, the documentation made available on the ECB website suggests the bonds in the maturity buckets range from 3 months to 30 years. Therefore a good deal of the	Noted. Is this serious?

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			bonds of interest to the insurance sector are consolidated into 2-3 data points which are averages of the bonds in the market. Some evidence would be useful, to illustrate how the ECB Euro-zone yield can be earned and how this compares to the ability to earn the swap rate. As described above we have some concerns about the technical bias and market distortion that would be introduced by mandating a single rate for the Euro-zone. This CP makes references to the TARGET calendar, which closes on 1st January and at weekends. This implies that the ECB Yield Curve is closed on 1st January and weekends. It would be helpful to understand if this means that the 31st December yield curve will not be available until at least 2nd January. This could be relevant given the tight timescales many firms work to over the year end as it will delay the calibration of ESG models used for the market consistent valuation.	
620.	Legal & General Group	3.58.	As per 3.55	See resolutions there.
621.	Lloyd's	3.58.	We agree.	Noted.
622.	OAC plc	3.58.	As per 3.55	See resolutions there.
623.	PricewaterhouseCoopers LLP	3.58.	See comments under 3.34	See resolutions there.
624.	Prof. Antoon Pelsser, Maastricht University	3.58.	Delete: not principle based.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
625.	RBS Insurance	3.58.	Explicit recommendation from CEIOPS about the discount rate to use in the Euro (€) area. This recommendation looks sensible for the euro.	Noted.
626.	ROAM – Draft V2	3.58.	Risk free rate yield curve for euro CEIOPS says: the ECB government yield curve should be used as the relevant risk-free rate term structure for euro. As mentioned above, ROAM disagrees on treating the determination of risk free rate yield curve in different level: euro currency at level 2 and other currencies at level 3. ECB AAA government yield curve is based on an implicit ponderation of the AAA of each country in the Euro zone. This could lead to “benchmark issues” because of the size, liquidity and market depth in some of the countries of the Euro zone ECB AAA government bond yield curve is interpolated with Nelson Siegel model which 1) does not allow a perfect fit of all the points on the curve and 2) might not be consistent with the methodology finally required by the CEIOPS for any interpolation of the risk-free yield curve Furthermore ROAM is not convinced that using the ECB government yield curve for euro addresses the consistency between currencies and believes that Swap curve (option 1) is more likely to address this matter. Moreover, if a risk free interest yield curve is defined for a given currency at Level 2 (and ROAM supports this), it has to be defined for all currencies to avoid distortions.	See resolutions there.
627.	UNESPA (Association of Spanish	3.58.	See comments to Para 3.54	See resolutions there.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	Insurers)			
628.	AMICE	3.59.	See comments to paragraph 3.43	
629.	Association of British Insurers	3.59.	See 3.47	
630.	ASSOCIATION OF FRIENDLY SOCIETIES (AFS)	3.59.	We believe that it will be impossible to find a uniform method that is appropriate to all currencies and times and suggest that CEIOPS allow firms to explain the rate they will use.	
631.			Confidential comment deleted.	
632.	AVOE – Aktuarvereinigung Österreichs – Actuarial	3.59.	In our view the macro-economic extrapolation technique seems to be the best of the three proposed approaches since avoiding volatilities by macro-economic parameters. To reduce the danger creating volatility via misstatement through faulty analysis might be overcome by applying gliding averages over some years (preferably shorter than the 10 years as applied under Solvency I for setting the maximum interest rate for reserving). Some attention should be put to how to define the process on how to set a common “expert opinion”. The extrapolation parameters applied should be published by the undertaking to increase transparency. The gliding average approach (e.g. averaging the long term interest rates of the last 12 – 20 quarters) might also be a base for setting the long term interest rate under IFRS to avoid too volatile balance sheet reserves as well.	
633.	Bupa	3.59.	What about extrapolation down to 1 month as well as the monthly points on the yield curve for those insurance classes whose	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			liabilities typically run off within one year? The shorter end of the yield curve can fluctuate significantly and can have significant convexity/concavity. The basis should be explicit to avoid confusion with firms, supervisors, auditors, etc. Leaving this issue ambiguous and up to discretion of firms could lead to a variety of approaches, which in turn could (ironically) decrease the consistency of basis and increase estimation error across the market in respect of short term insurance classes. This is connected to paragraphs 3.10 and 3.38.	
634.	CEA, ECO-SLV- 09-434	3.59.	See comments to Para 3.47.	
635.	CRO Forum	3.59.	We welcome CEIOPS recognition of the merits and drawbacks of the three proposed approaches. However, CRO forum would like to highlight that the application of the these approaches is highly dependent on the availability of the data in a given market. We recommend that the undertakings should be allowed to use the most appropriate approach, in light of the available data, and disclose the adopted extrapolation method. We furthermore advocate a transparent, not overly complicated way of extrapolation that does not lead to spurious volatility within the valuation exercise. Practicability especially in the system implementation is another important issue to consider. Hence, a sensible balance should be struck between theory and pragmatism.	
636.	DIMA (Dublin International	3.59.	We support an extrapolation methodology which reduces volatility.	

Summary of Comments on CEIOPS-CP-40/09 CEIOPS-SEC-103-09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
	Insurance & Management			
637.	FFSA	3.59.	Extrapolation beyond the last available point of sufficient liquidity CEIOPS is still forming its position and welcomes for comments and suggestions. FFSA believes that the simple extrapolation technique using the final liquid point on the forward curves is an appropriate and simple approach.	
638.	German Insurance Association – Gesamtverb and der D	3.59.	See comments to Para 3.47	
639.	Groupe Consultatif	3.59.	See earlier comments From our point of view macroeconomic extrapolation techniques in combination with mathematical techniques for a smooth extrapolation of market data is a reasonable approach for long-term valuations. The approach should be based on the longest observable market data (forward rates and forward rate volatilities), macroeconomic considerations for the long-term equilibrium level of the unconditional forward rate and a mean-reversion-effect of interest rates. Using appropriate mathematical techniques a smooth path from the longest observable interest rates to the long-term equilibrium level should be deduced from observed yield curve behaviour and interest rate volatility (e.g. an approach of Barrie & Hibbert for ultra long-term cash flows). The definition of the mathematical approach and the fixing of the parameters should ensure a level playing field for European	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			insurers, which excludes arbitrage between different countries. The other methods lead to high volatility in the valuation, because they depend on one data point of sufficient liquidity. When insurance companies try to reduce their interest rate risk and hedge long-term cash flows, this yields downward pressure on the longer maturities in the term structure. As a result, it can be concluded that the use of these methods represents an interference with the business strategy of particularly life and health insurers (i.e. the diversification of risks over time) such that costs are at the expense of the policyholders. In addition, unstable long-term interest rate levels lead to highly volatile solvency ratios. This does not promote customer confidence.	
640.	Investment & Life Assurance Group (ILAG)	3.59.	We believe that it will be impossible to find a uniform method that is appropriate to all currencies and times and suggest that CEIOPS allow firms to explain the rate they will use.	
641.	KPMG ELLP	3.59.	We are of the view that (re)insurance undertakings should be allowed to choose and fully disclose the approach and methodology which they use for extrapolation. The disclosure could be complemented by sensitivity testing and/or results produced using an alternative methodology. It may be difficult in practice to find a single approach that will apply in all circumstances. However CEIOPS has requested the views of stakeholders so we provide ours below: We agree with CEIOPS observation that a simple extrapolation of the last liquid data point would produce excessively volatile long term rates. It would for example be particularly penal for long term pension providers in countries with a short duration government bond or swap market.	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			We would expect an ultra long-term interest rate (say 100-120 year spot rate) to have a particularly low volatility as there would be little new information received on a day to day basis that could reasonably alter out view of rates 100 years from now. On this basis we would consider a term structure construction that resulted in interest rate volatility decaying exponentially with interest rate term to be appropriate. Subjective choices would need to be made regarding the very long term interest rate and the speed of decay beyond the last liquid data point and the assumptions and methodologies behind these should be fully disclosed, especially where they have a material impact on the valuation. We would have a preference for the macro-economic approaches rather than extrapolations heavily influenced by illiquid long term instruments or flat constant extrapolations of the last liquid point. We would also point out that the last liquid data point could change from reporting period to reporting period and that this should not introduce excessive balance sheet volatility by virtue of the extrapolation method. We consider that a macro-economic approach would best meet this requirement.	
642.	Legal & General Group	3.59.	As per 3.55	
643.	Munich RE	3.59.	We welcome CEIOPS recognition of the merits and drawbacks of the three proposed approaches. However, we would like to highlight that the application of the these approaches is highly dependent on the availability of the data in a given market. We recommend that the undertakings should be allowed to use the most appropriate approach, in light of the available data, and disclose the adopted extrapolation method.	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			We furthermore advocate a transparent, not overly complicated way of extrapolation that does not lead to spurious volatility within the valuation exercise. Practicability especially in the system implementation is another important issue to consider. Hence, a sensible balance should be struck between theory and pragmatism.	
644.	OAC plc	3.59.	As per 3.55	
645.	PricewaterhouseCoopers LLP	3.59.	See comments under 3.45 and 3.46	
646.	RBS Insurance	3.59.	This may need to vary by territory or apply with adjustments if particular bond markets have technical biases.	
647.	ROAM – Draft V2	3.59.	Extrapolation beyond the last available point of sufficient liquidity CEIOPS is still forming its position and welcomes comments and suggestions. ROAM believes that the simple extrapolation technique using the final liquid point on the forward curves is an appropriate and simple approach.	
648.	UNESPA (Association of Spanish Insurers)	3.59.	We believe that it is important that no specific extrapolation technique is specified at Level 2, rather the principles that should be met by the technique are provided. Obviously, appropriate harmonisation should be ensured through Level 3 measures.	
649.	Uniqa	3.59.	A combined interest curve with data from markets and model data means also a mixture of systems. So if a macro economic model is used for long term rates, it should be used also for the whole interest rate curve. This would reduce volatility in results and makes them less dependent on short term market movements. But if the short term rates are market rates, they should be used	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			for the whole curve as long available and a more simple approach would be favourable.	
650.	European Insurance CFO Forum	3.46.	The 'constant spread method' for extrapolating yield curves for non-Euro currencies has shortcomings which make it unsuitable in practice. The proposed 'constant spread method' does not take into consideration differences in the shapes of yield curves of different currencies prior to the last available liquid data point. For example, if the Euro curve is steep upwards sloping and a non-Euro curve is steep downwards sloping with the last mutually available liquid data point being the point where the two curves cross, then the non-Euro curve will be extrapolated to be steep upwards sloping despite being steep downwards sloping prior to the last available liquid data point. Therefore we do not believe that this method is appropriate. Comments in 3.38 are also relevant here.	
651.	Lucida plc	A.	It would be helpful for an example to be given alongside this Annex, as some of the wording is not particularly clear	
652.	Groupe Consultatif	A.1.	Further information is required for fuller consideration of this Swedish proposal, but it is not clear to us at this stage that it includes a sufficient macroeconomic 'anchor'.	
653.	Deloitte Touche Tohmatsu	A.3.	The high volatility of long term rates would be a poor argument for fixing long term rates. Thankfully, the evidence does not support this claim, and indeed in most currencies long dated interest rates are less volatile than medium term rates. If the asymptotic long rates for very long term rates are constant, then we would expect to see observed rates becoming less volatile for longer terms – which indeed is just what happens.	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
654.	CRO Forum	A.5.	This point also illustrates that government bonds also experience periods of illiquidity and technical bias.	
655.	Lucida plc	A.12.	There seems to be no theoretical reason why this approach is appropriate. Nor is it clear what should be done if the “deduction” turns out to be a positive modifier.	
656.	CRO Forum	B.	The macroeconomic approach could be refined by using a more market consistent notion, e.g. via considering additional market data when setting the unconditional rate.	
657.	Groupe Consultatif	B.	Generally we believe that the approach outlined in this section is more conducive to stability than that outlined in Section A.	
658.	CEA, ECO-SLV-09-434	B.4.	This problem would also arise within the euro market when the attention is restricted to the ECB AAA government bonds (see comments to Para 3.14 to 3.18).	
659.	CRO Forum	B.4.	We would like to stress it importance of this point for international insurance companies. For those that are doing business in many countries, modelling of a significant number of different currencies with a majority of these curves have less than 30 years of market data. While a macroeconomic approach is not required for currencies such as EUR and USD with 50yrs of market data (at least in the swap market), it becomes in our view the only feasible route for curves where just 10 to 30yrs of market data is available.	
660.	Groupe Consultatif	B.5.	We recognise the force of this argument and believe this approach warrants further consideration.	
661.	CRO Forum	B.6.	We believe that a third element needs to be considered on top of the real interest rate and the expected inflation. This is a convexity adjustment. From Developed markets you can clearly and consistently observe an negative slope of the forward interest rate curve beyond the 20 year tenor which is caused by this convexity	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			adjustment. The graph in C2 also illustrates the existence of a negative convexity adjustment beyond 20yrs for the UK market.	
662.	CEA, ECO-SLV-09-434	B.7.	The choice of maturity is arbitrary, but important. If this maturity is deemed to be too long, then the practical impact of the proposal will be reduced.	
663.	CRO Forum	B.7.	We should try to leverage market information from markets where long-term rates are available. In particular we can observe the forward real rates in EUR and USD markets for the 30yr tenor and hence bring more market consistency into this approach.	
664.	CEA, ECO-SLV-09-434	B.12.	One further economic justification for more volatility could be that monetary policy is more credible if the underlying economy is larger, less sensitive to external disturbances.	
665.	Lucida plc	B.12.	We disagree with the opinion that Norway and Sweden should have similar long-term interest rate volatility to the Euro-Zone. Some countries, for example, Norway and Sweden, in our opinion, have much greater freedom to raise or lower interest rates, and have less powerful currencies, so there is much more uncertainty.	
666.	BARRIE & HIBBERT	B.14.	See comment under 3.47.	
667.	BARRIE & HIBBERT	B.15.	See comment under 3.47.	
668.	CRO Forum	B.15.	See comment B6. We believe that a convexity adjustment can be observed and should be included.	
669.	CRO Forum	B.16.	This model makes sense to us although we prefer to base it on swap rather than on government rates. Furthermore we build in convexity adjustments beyond the 20yr tenor.	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
670.	Deloitte Touche Tohmatsu	B.22.	The CP asserts that “using the macroeconomic approach helps to avoid the most extreme volatility caused by distortions in the market”. We think this statement may be misleading. What the approach does is make the stated rate less volatile. It does not reduce volatility for an insurer whose assets and liabilities are duration matched – in fact, the macroeconomic approach increases volatility in this situation by smoothing the liabilities and not the assets. Furthermore, the fact that stated interest rate volatility is reduced does not imply that the volatility is caused by distortions – perhaps the volatility is really there and we introduce distortions by smoothing.	
671.	Association of British Insurers	C.	We strongly agree that a discount curve based on swaps, with appropriate adjustments for credit risk and liquidity should be used to derive the relevant risk-free discount rates. We agree with most of the points in this annex and offer a few specific additional comments	
672.	Association of British Insurers	C.1.	We agree that the UK government bond market is affected by significant technical bias.	
673.	Lucida plc	C.1.	We agree that there is significant technical bias in the government bond curve in the UK	
674.	CRO Forum	C.3.	An inverted yield curve also exists at the end of 2008 in Euro. It can be argued that technical bias exists there as well as for UK gilts.	
675.	CRO Forum	C.4.	Third bullet point. This argument can be applied to all government bonds and not just UK gilts i.e. supply/demand effects based on the level of government borrowing.	
676.	CEA,	C.5.	45. We are not sure that this should be a concern (point 1). To the extent that it is a concern, we suggest that it may not come	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	ECO-SLV-09-434		from liability management, but from shareholder capital management (point 2). If that is the case, that is the issue that needs to be addressed. R To the extent that positions are hedged from the initiation of the liabilities, there is only an initial market pressure, which is fully market consistent. If, for whatever reason, interest rates fall further, there is no pressure from the liabilities for further hedging, as they are already fully hedged. R If positions are not hedged from the start, this leads to an underweight duration position. Such a position should only be based on a view on interest rates, and should be supported by shareholder capital. It is not driven by liabilities. A fall in interest rates (view is wrong) may lead to a fall in shareholder equity, perhaps leading a desire to derisk. This is the same forced selling (derisking) that arises if active long equity positions turn sour. Arguably, one shouldn't reward such destabilising behaviour, and certainly not by altering the way we view liabilities. Rather, you should prevent it by ensuring that active risks are small relative to the amount of shareholder capital. This encourages timely hedging (reduced risk-taking with shareholder capital).	
677.	Association of British Insurers	C.6.	We would not agree that other government bond markets, such as euro and dollar, are free from these distortions	
678.	CEA, ECO-SLV-09-434	C.6.	We suggest that the negative swap spread in the euro zone can also be partially attribute to this effect.	
679.	CRO Forum	C.7.	The comments here seem to support the choice of the swap curve as the liquid and more unbiased basis for interest rates rather than	

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			using the government curve.	
680.	Groupe Consultatif	C.7.	We interpret these comments as supporting a flexible approach to blending of bond and swap rates as we have advocated earlier.	
681.	Lucida plc	C.7.	We agree that investment banks have a strong incentive to meet the demand for swaps, but would note that this is limited to the amount of risk they are willing to put on their own balance sheet or are able to transfer to a willing counterparty. It could be argued that recently this limitation has caused technical bias in the swap curve.	
682.	The Equitable Life Assurance Society (UK)	C.7.		
683.	Association of British Insurers	C.15.	We agree that the extent of the borrowing currently being undertaken by governments has resulted in questions being raised with regard to the credit quality of their debt. Any downgrading of a government would have a significant impact on the government bond curve. This is not limited to the government of the UK	
684.	Association of British Insurers	C.16.	We agree that swaps are also indirectly affected by monetary policy. However swaps are not used as a tool of monetary policy and are therefore less likely to be affected by monetary policy interventions. This is not limited to the UK	
685.	CRO Forum	C.17.	We believe that it is not possible to state that government bonds are fully risk-free (see e.g. comment to 3.4.). We do agree with the argumentation that swap rates only contain a small margin for credit risk and that credit risk may be immaterial on swap transactions.	
686.	Lucida plc	C.17.	We note that there is remaining credit risk despite collateralisation	

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			due to the delay in collateral calls taking place and the cost of replacing swap trades in the event of the default of a counterparty.	
687.	Lucida plc	C.18.	We agree that there is credit risk involved in covering the interest rate swap	
688.	Lucida plc	C.26.	We agree that zero coupon swap rates are not publicly available. It is unclear whether the practice of having the regulator produce an average of rates provided solely for the purpose would be consistent with an insurer being able to actually achieve those rates in a transaction with an investment bank.	
689.	Association of British Insurers	C.30.	We agree that there is no "perfect" specimen risk free curve. Any curve used will require appropriate derivation and adjustment to reflect the nature of the associated insurance liabilities	
690.	CRO Forum	C.30.	We agree that there is no perfect risk-free curve. However, we do think that swap rates are a better proxy for the risk-free curve for many reasons, see 3.4., 3.7., 3.10. etc.	
691.	Association of British Insurers	C.31.	We agree that swaps in general provide a better starting point than government bonds to derive the relevant discount rates	
692.	European Insurance CFO Forum	C.31.	The CFO Forum supports the statement that "swaps may be considered to be superior to gilts in respect of some of the other criteria".	
693.	Lucida plc	C.31.	We agree that swaps are superior to gilts in the UK market for the purposes of establishing a risk-free term structure	
694.	Association of British Insurers	C.32.	We agree that in normal times the relevant risk free discount rate should be the swap curve less an adjustment for credit risk (with an adjustment also for liquidity in defined cases). We also believe that some flexibility should be allowed, since in distressed conditions it may be necessary to look at a wider range of instruments and	

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate			
			reference rates, which could include government bonds, to achieve an appropriate discount rate.
695.	FFSA	C.32.	See 3.49
696.	Just Retirement Limited	C.32.	It is difficult to comment on the validity of the proposed approach for GBP denominated liabilities, because no guidance is given in relation to the derivation of the "adjustment for credit risk". Further information is needed on how this adjustment would be derived.
697.	The Equitable Life Assurance Society (UK)	C.32.	It is noted in C.7. that the swap curve also suffers from technical bias. Any such bias is likely to be more severe in extreme market conditions. It is in extreme conditions that solvency margins will come under pressure, making it imperative that the risk-free yield curve is not distorted by technical bias in such conditions. In practice it may be that more weight would need to be given to some or all parts of the gilt curve in certain adverse conditions, or that further adjustments to the swap curve would be required.
698.	CEA, ECO-SLV-09-434	C.33.	In our opinion Appendix A seems to focus on extrapolation rather than on credit risk adjustments.
699.	Lucida plc	C.33.	It is not clear, given the acknowledgement of the shortcomings of the UK gilt-market, that the Swedish model would give an acceptable adjustment. In the case of the long-term gilt yield being higher than the long-term swap rate, this approach does not appear to meet the requirement to reduce the swap yield to allow for credit risk.
700.	PricewaterhouseCoopers	C.33.	The conclusion in Annex C is that the liquid risk free term structure for UK pound sterling is the swap curve less an adjustment for

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	LLP		credit risk. The method to derive the adjustment is deferred to a later stage. This will be essential to determine the appropriateness of the term structure. It would be helpful to have clarity as to the timeframe for determining the adjustment and the relevant external consultation period.	
701.	CRO Forum	D.	One element that CP40 does not consider when assessing the various alternatives for the risk free rate, is the consistency with traded option instruments that are inter alia used for calibration of market consistent scenarios to value embedded guarantees/optionalities in insurance liabilities. Market implied volatilities for both equity and interest rate options are quoted based on the swap curves. CP39 correctly states that a market consistent model should be calibrated to the respective risk free curve. However, when this curve is not the swap curve then market consistent pricing in the insurance world will move away from market consistent pricing in the bank world. Moreover, the calibration will become a very cumbersome process and there are no liquid derivatives directly based on the government curve. Therefore using a government curves to value options and guarantees will not lead to prices as observed in the market. We would like to emphasize here that the most important valuation principle underlying the Framework Directive is market consistent prices	Noted.
702.	Groupe Consultatif	D.	The impact assessment has not taken into account the full requirements of Directive 2002/83/EC Article 20, the existing requirements covering the establishment of technical provisions. For single premium contracts for a period up to eight years, without-profit contracts and annuity contracts with no surrender value there is no maximum interest rate of 60% of the rate on bond issues by the State in whose currency the contract is denominated. In these cases the prudent rate of interest can be	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			based on the corresponding assets currently held	
703.	Legal & General Group	D.	The impact assessment has not taken into account the full requirements of Directive 2002/83/EC Article 20, the existing requirements covering the establishment of technical provisions. For single premium contracts for a period up to eight years, without-profit contracts and annuity contracts with no surrender value there is no maximum interest rate of 60% of the rate on bond issues by the State in whose currency the contract is denominated. In these cases the prudent rate of interest can be based on the corresponding assets currently held. In the UK, annuity contracts without surrender values account for approximately £150bn of liabilities. These liabilities are closely matched with a high proportion invested in corporate bonds. The interest rates used to value these liabilities takes into account the assets held to back these liabilities. A deduction is made from the available yield for a prudent amount of credit risk, however, as there is no surrender value and therefore persistency exposure, the balance of the yield, including illiquidity premium relative to government bonds is available for discounting these annuity liabilities. The interest rate used for discounting these liabilities is therefore in excess of the government bond rates. The proposed risk free interest rate based on government bonds would result in a very large increase in these annuity liabilities. Further, the assets backing these liabilities being corporate bonds would be subject to the credit spread stress. As the definition of risk free rates does not recognise that there are no surrender values the full widening of spreads is disallowed creating a very large capital charge.	Noted.

Summary of Comments on CEIOPS-CP-40/09			CEIOPS-SEC-103-09																																	
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate																																				
		sensitivity of the values of assets, liabilities and financial instruments to changes in the level or volatility of credit spreads over the risk-free interest rate term structure. The advice for CP 47 paragraph 4.73 states that: "No capital charge shall apply for the purposes of this module to borrowings by or guaranteed by national government of an OECD or EEA state, issued in the currency of the government". Defining AAA rated government bonds as the benchmark for credit risk-free rates creates an inconsistency between the definition of the SCR credit spread module and the technical provisions as a market risk is created for non AAA rated government bonds of an OECD or EEA state without required to be held. To illustrate this risk the returns on German 10 year bonds have been compared with other governments Euro denominated debts across the period June 1999 to June 2009. The range of relative annual returns are set out below: <table><tr><td></td><td>Min</td><td>Max</td></tr><tr><td>Republic of Austria</td><td>-5.12%</td><td>1.50%</td></tr><tr><td>Kingdom of Belgium</td><td>-4.77%</td><td>2.00%</td></tr><tr><td>Republic of Finland</td><td>-3.79%</td><td>1.52%</td></tr><tr><td>Republic of France</td><td>-2.32%</td><td>0.77%</td></tr><tr><td>Republic of Greece</td><td>-12.72%</td><td>2.34%</td></tr><tr><td>Republic of Ireland</td><td>-11.22%</td><td>1.30%</td></tr><tr><td>Republic of Italy</td><td>-7.48%</td><td>2.75%</td></tr><tr><td>Kingdom of Netherlands</td><td>-3.69%</td><td>0.89%</td></tr><tr><td>Republic of Portugal</td><td>-5.55%</td><td>2.06%</td></tr><tr><td>Kingdom of Spain</td><td>-5.02%</td><td>1.40%</td></tr></table> All of these countries have a credit rating between "AAA" and "A",		Min	Max	Republic of Austria	-5.12%	1.50%	Kingdom of Belgium	-4.77%	2.00%	Republic of Finland	-3.79%	1.52%	Republic of France	-2.32%	0.77%	Republic of Greece	-12.72%	2.34%	Republic of Ireland	-11.22%	1.30%	Republic of Italy	-7.48%	2.75%	Kingdom of Netherlands	-3.69%	0.89%	Republic of Portugal	-5.55%	2.06%	Kingdom of Spain	-5.02%	1.40%	
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Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			year for risk of default. The table above illustrates that for all the countries including the Republic of Germany significant changes in the relative value of government bonds occur. For example, a liability in Greece of 100 with 100 invested (fully matching) in 10 year Greece government bonds has at the extreme moved over 1 year to a value of assets of 87 with the liability unchanged at 100, creating a shortfall in assets of 13. Using a definition of AAA rated government bonds as the benchmark for credit risk free rates creates a systematic risk for the insurers in all these countries as a change in the relative value of government bonds is not reflected in a commensurate change in liabilities. No capital is provided for this risk and therefore the confidence level of 99.5% over a one-year period is not reached. If the liquidity premium in the bond yields was recognised in the defining of the risk free interest rate term structure then this risk would not exist, no additional capital would then be required to be held and the SCR spread risk module would be acceptably calibrated. It is essential that the method used to derive the risk free rate can be applied and leads to appropriate interest rate and credit spread stresses being calculated in order to reflect the inherent risks of liabilities.	
704.	OAC plc	D.	Our response to paragraph 3.54 has shown that the definition of the risk free interest rate as defined by CEIOPS when taken with the calibration of the spread risk module produces a capital requirement that goes beyond 1:200. The impact assessment has not taken into account the full requirements of Directive 2002/83/EC Article 20, the existing requirements covering the establishment of technical provisions. For single premium contracts for a period up to eight years,	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			without-profit contracts and annuity contracts with no surrender value there is no maximum interest rate of 60% of the rate on bond issues by the State in whose currency the contract is denominated. In these cases the prudent rate of interest can be based on the corresponding assets currently held. In the UK, annuity contracts without surrender values account for approximately £150bn of liabilities. These liabilities are closely matched with a high proportion invested in corporate bonds. The interest rates used to value these liabilities takes into account the assets held to back these liabilities. A deduction is made from the available yield for a prudent amount of credit risk, however, as there is no surrender value and therefore persistency exposure the balance of the yield, including illiquidity premium relative to government bonds is available for discounting these annuity liabilities. The interest rate used for discounting these liabilities is therefore in excess of the government bond rates. The proposed risk free interest rate based on government bonds would result in a very large increase in these annuity liabilities. Further, the assets backing these liabilities being corporate bonds would be subject to the credit spread stress. As the definition of risk free rates does not recognise that there are no surrender values the full widening of spreads is disallowed creating a very large capital charge.	
705.	Groupe Consultatif	D.4.	As noted in earlier comments we have grave reservations on stability grounds about linking the unobservable risk-free interest rate term structure to a single class of instrument.	Noted.
706.	Just Retirement Limited	D.7.	The term structure should be provided with great rapidity after each valuation date (ideally on the following calendar day) to avoid adverse impact on undertakings' internal and external deadlines for publication of results.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			The central institution must introduce very strong controls on the production of term structures to avoid subsequent revisions. It must also follow the highest standards of disclosure in publishing the underlying data and methodology used in the derivation of the published results, so that undertakings can scrutinise and have full confidence in the risk free rates being used.	
707.	Groupe Consultatif	D.13.	As noted earlier we favour this option as contributing optimally to stability.	Noted.
708.	BARRIE & HIBBERT	D.16.	See comment under 3.30.	Noted.
709.	Groupe Consultatif	D.16.	This appears to be an inappropriately prescriptive view.	Noted.
710.	BARRIE & HIBBERT	D.17.	See comment under 3.30.	Noted.
711.	CEA, ECO-SLV-09-434	D.17.	See comments to Para 3.30.	Noted.
712.	CRO Forum	D.17.	The absence of a generally accepted method does not mean that an illiquidity premium does not exist. Most stakeholders accept that it exists and has been material in the last 12 months. We would suggest that it exists and a consistent method for identifying the illiquidity premia should be developed (see 3.30.).	Noted.
713.	Just Retirement Limited	D.17.	As discussed above, we believe that an illiquidity premium should be recognised when valuing appropriately illiquid liabilities, as is the case under Solvency I in certain member states. It would have been useful to consider the financial impact of the de-recognition of the illiquidity premium in the impact assessment. Industry estimates that the impact on the UK insurance industry in relation	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			to annuity liabilities would have been of the order of €50bn at 31 December 2008 (as quoted in the Financial Times, 24 August 2009). This is clearly not a trivial impact and is likely to be more consequential than the choice between swaps and gilts, and therefore requires greater investigation and debate.	
714.	Lucida plc	D.17.	Although we agree that there is no generally acknowledged method for deriving the illiquidity premium, we believe that this should not prevent insurers from making allowance for such a premium where liabilities are illiquid. We would recommend that the industry and the supervisors should agree on an approach incorporating a liquidity premium, for example by specifying a proportion of the yield or spread that can be incorporated as liquidity premium (but retaining the ability to keep this proportion under review). Insurers will be able to diverge from prescribed approaches in other areas of Solvency II and we believe that insurers should be allowed similar latitude in deriving the risk free interest rate.	Noted.
715.	PricewaterhouseCoopers LLP	D.17.	See comments under 3.30	Noted.
716.	UNESPA (Association of Spanish Insurers)	D.17.	See comments in point 3.30	Noted.
717.	BARRIE & HIBBERT	D.18.	See comment under 3.30.	Noted.
718.	CEA, ECO-SLV-09-434	D.18.	See comments to Para 3.30.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
719.	DIMA (Dublin International Insurance & Management	D.18.	We support a risk free rate based on SWAPS with some allowances for illiquidity premium.	Noted.
720.	Groupe Consultatif	D.18.	See our comment on 3.30 above.	Noted.
721.	Ireland's Solvency 2 Group, excluding representa	D.18.	Others are more qualified to comment on the derivation of reliable measures for the liquidity premium. Our main comment is that there is ample evidence for the existence of a liquidity (or more correctly illiquidity) premium and it would seem perverse not to allow for it when liabilities are illiquid. One of the key arguments in its favour is that it helps to address pro-cyclicality, which is generally agreed to have been one of the major contributors to the recent global financial crisis. Any measures which help to address pro-cyclicality are to be welcomed.	Noted.
722.	Pricewaterho useCoopers LLP Noted.	D.18.	See comments under 3.30	Noted.
723.	UNESPA Noted. (Association of Spanish Insurers)	D.18.	See comments in point 3.30	Noted.
724.	Groupe Consultatif	D.21.	We do not agree that a decrease in technical provisions of itself will lead to a higher degree of default probability of undertakings – this will depend on calibration of SCR.	Noted.
725.	Just Retirement	D.21.	No comment is made on the impact on entities in those Member States where the maximum Solvency I valuation interest rate is not	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
	Limited		based on 60% of government bond rates, for example where the valuation interest rate is based on the yield on the assets backing the liabilities. For these entities the eligible own funds are unlikely to increase, and in many cases could substantially decrease, and perhaps result in technical insolvency under Solvency II, notwithstanding robust solvency under the Solvency I regime even in highly distressed market conditions. Clearly such an outcome would be highly undesirable, perhaps requiring similar government support to be provided to distressed insurers as has recently been provided to the banking sector.	
726.	Legal & General Group	D.21.	Paragraph D.21. is incorrect in relation to annuities with no surrender values as it will lead to a very large increase in technical provisions (and capital requirements). Our assessment is that the UK £150bn of annuity liabilities will increase by between £30bn and £60bn as at 31 December 2008. We do not believe that it would be feasible to raise £30bn to £60bn of new capital just for these annuity liabilities. In addition we believe that as a result up to £100bn of corporate bonds would have to be sold and invested in government bonds. £100bn represents over 10% of the fixed corporate bond market and over 10% of the UK government bond market so this would cause a prolonged distortion to the financial markets. For annuity business the increased capital requirements would result in a reduction of annuities of at least 20%. The UK pension provision has a high reliance on both private pension provision and corporate money purchase arrangements. The changes would therefore reduce the UK's average retirement income and is likely to significantly reduce savings for such contracts.	Noted.
727.	OAC plc	D.21.	Paragraph D.21. is therefore incorrect in relation to annuities with no surrender values as it will lead to a very large increase in	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
			technical provisions (and capital requirements). Our assessment is that for the UK annuity liabilities will increase by between 20% - 40%. We do not believe that it would be feasible to raise this amount of new capital. In addition we believe that as a result up to 10% of the corporate bond market having to be sold creating market turbulence. For annuity business the increased capital requirements would result in a reduction of 20%+ of the value for policyholders. The UK pension provision has a high reliance on both private pension provision and corporate money purchase arrangements. The changes would therefore reduce pension	
728.	CEA, ECO-SLV-09-434	D.26.	We disagree with this statement. See comments to Para 3.8.	Noted.
729.	CRO Forum	D.26.	We think that discounting at a government rate is not in the interest of our policyholders as this might increase the amount of the technical provision compared to the one required on a true risk free basis. This will increase the costs of insurance to the customer. It also important to policyholders that the discount rate does not lead to increased pro-cyclicality in the market endangering their investment. We believe using AAA government bonds as the discount rate would have a strongly pro cyclical effect. However, it should be stressed again that also swap rates can be lower than Government rates.	Noted.
730.	UNESPA (Association of Spanish Insurers)	D.26.	Policyholders will have a better protection under the option 5 - In options 1, 2 and 5, the company will gain the "risk-free rate". - For the illiquid liabilities, the use of the government bond curve would increase the liability value in an artificial way. Eg. On	Noted.

Summary of Comments on CEIOPS-CP-40/09				CEIOPS-SEC-103-09
Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				
			the Spanish case “rentas de Jubilación”, annuities after retirement, the illiquidity component is quite significant. Due to that, insurance undertakings invest the technical reserves in assets with a credit and in many cases with an illiquidity component. This is reflected in a lower price of the product. The not inclusion of the existence illiquidity premium, will clearly penalise this kind of products, so the insurance companies will be force to increase the annuity price in a way that it would be reflected the lower profitability coming from the substitution of the current credit portfolios for government bonds. - The use of the swap curve would allow the insurance company to better understand their market value. See our comment in paragraph 3.13 on the conditions of emission of government bonds - Finally, it is clear that in areas with less developed swap curves, it should be use other curves, and for that Option 5 should be the best rated.	
731.	Lucida plc	D.27.	We agree that policyholders will be penalised where options are chosen that reduce the rates assumed for the risk-free term structure	Noted.
732.	Just Retirement Limited	D.30.	Similar to the comment for D21 above, there are cases where neither D29 nor D30 apply – these situations appear not to have been considered.	Noted.
733.	Lucida plc	D.31.	We do not agree that there will be a negative impact on supervisory authorities where the requirement will lead to them having a greater understanding of the economic theory behind the setting of risk-free term structures.	Noted.
734.	Groupe Consultatif	D.32.	We do not recognise the rationale for the comments here.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
735.	Lucida plc	D.32.	If all insurers use the same approach then the possibility of transfer of the technical provisions will be unchanged.	Noted.
736.	Groupe Consultatif	D.40.	We recognise this graph in its context of hypothetical 'normal circumstances' – as noted earlier, such traditional relative relationships have been behaving differently against the background of the crisis.	Noted.
737.	RBS Insurance	D.40.	We understand that the longer yield risk free interest rate is of critical importance to annuity writers. It is also potentially of importance to non-life insurers from the exposure to long-term liabilities e.g- motor injury claims settled via periodic payments (even if not currently material, changing legal settlements could make it important). Since this is important to the UK industry, the impact assessment should be conducted for this member state.	Noted.
738.	Groupe Consultatif	D.44.	As noted earlier, we believe that the Level 1 text does not require the risk free rate term structure to be associated with a single instrument or class of instrument.	Noted.
739.	CEA, ECO-SLV-09-434	D.51.	We strongly disagree with this conclusion.	Noted.
740.	FFSA	D.51.	See 3.54	Noted.
741.	KPMG ELLP	D.51.	The analysis in Annex C of this consultation paper has indicated that for some economies other instruments such as swaps may meet the risk free criteria to a better extent than government bonds. We suggest that CEIOPS consider an approach where the instrument for a given economy is chosen on the basis of a detailed analysis of available instruments which may meet the risk free criteria.	Noted.

Summary of Comments on CEIOPS-CP-40/09 Consultation Paper on the Draft L2 Advice on TP - Risk free interest rate				CEIOPS-SEC-103-09
742.	ROAM – Draft V2	D.51.	See 3.54	Noted.
743.	UNESPA (Associatio n of Spanish Insurers)	D.51.	See comments in D.26	Noted.