Comments Template on the Consultation Paper on the methodology to derive the UFR and its implementation			Deadline 18 July 2016 23:59 CET
Name of Company:	Institut des Actuaires (France)		
Disclosure of comments:	Please indicate if your comments should be treated as confidential:		Public
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Reference	**Comment**		
General Comment	The Institut des Actuaires welcomes EIOPA's invitation to comment on this consultation. The historically low level of the interest rates is a matter of highest concern for the Institut des Actuaires. The reduction in interest rates, which has twice in recent years exceeded the prudential stress scenarios, does clearly incent to take measures so that the prudential framework takes duly into account this new context. On the consultation paper, we have the following general comments:		

	▪ Article 47 states that : "The UFR is stable and only changes as a result of changes in long-term expectations." In our opinion, a proposal to make a material change to the level of the UFR within the first year of the new Solvency II regime could indicate some inconsistency in the regulations'frame. ▪ It is somewhat surprising that from the 1st year of application, an element wich is the result of a change in the very long term prospects needs to be changed. ▪ The UFR is a key element of the SII prudential framework and is linked to other parameters, that have been clarified after a long run process of overall calibration. ▪ It would be more consistent with the spirit and intent of the UFR rules to consider a review only once the stakeholders to the review process will be able to take into account (a) the findings from the EIOPA 2016 stress testing exercise (which includes data collection of UFR sensitivities), (b) EIOPA's review of the impact of long-term guarantee measures, and (c) EIOPA's review of the standard formula. ▪ Quantitative impacts on volatility of cash flows are not sufficiently known at this stage and it is regrettable that consultation ends before the publication of EIOPA 2016 stress testing exercise ▪ The proposed annual limit modification of the UFR 20 bp must be challenged based on quantitative impacts. ▪ In addition to the quantitative analysis provided in the consultation, we would recommend that EIOPA includes a <u>qualitative</u> analysis of the views of central bankers, macro-economic forecasters and other bodies to complete the analysis with the market's view of long-term expectations. This qualitative analysis will ac acts as a useful sense check against the data analysis. ▪ The change in UFR (before any limit) for Euro currency is a material 50bps step reduction.	

	Sharp movements in the UFR are not easy to implement for insurance undertakings to hedge and to factor into their risk management. Hence, we welcome the consideration of an annual limit and recommend phasing in of changes to the UFR. ▪ The impact analysis provided in section 4 of EIOPA's paper is based one some illustrative examples for certain contracts. For a change of the proposed magnitude, we would recommend that an aggregate impact analysis is performed, based on more recent aggregate data for the insurance sector collected from National Competent Authorities.	
Q1. (pg. 56)	**Q1: The proposed methodology is based on the same calculation approach that was used to calculate the current UFRs, in particular UFR is proposed to be the sum of expected real rate and expected inflation. Do you agree with that approach?** IA agrees with the basic principle that UFR should equal the sum of the expected real interest rate and expected inflation rate. However, we have concerns on the approach used to determine each component and the frequency with which the UFR would be refreshed. For instance there is no evidence that using time weight in calculation should be more appropriate then using a simple average, as the current rates are a direct result of ECB monetary policy which is not intended to remain in place over the long-term. Another exemple is about using 3-months interbank interest rates to estimate a 1 year rate witch could lead to under estimate long term UFR.	
Q2. (pg. 56)	**Q2: According to the proposed methodology the expected real rate is calculated on the basis of past real rates since 1960 (widening window approach). Do you consider that to be an appropriate period for averaging the past real rates?** Whether this window is appropriate, it can only be considered in conjunction with whatever weighting is applied to the periods within the window. We note the chart on page 20 of the consultation paper which seems to imply that the calculated average from the widening window seems to exhibit material variation over time. EIOPA should test the stability of the widening window approach to ensure that the UFR remains stable over time.	

Q3. (pg. 56)	**Q3: The expected real rate of the proposed methodology is derived as a weighted average of past real rates. Which weights do you consider appropriate for that purpose?** This is an expert judgement – Theoretically, there is no correct weighting approach. In the absence of any statistical evidence that can be used to prove that more recent data could be a better predictor of the long-term average, equal weighting seems a reasonable default approach.	
Q4. (pg. 56)	**Q4: According to the proposed methodology, there are four buckets for the expected inflation rate (1%, 2%, 3% and 4%). Do you consider it appropriate to use inflation buckets and the choice of buckets adequate?,** We have no major objection to the bucketing approach.	
Q5. (pg. 56)	**Q5: The proposed methodology includes a limit to the annual change of the UFR of 20 bps. Do you consider such a limit necessary and appropriate?** Yes, a limit on the annual change would be appropriate and would provide greater predictability for the purposes of risk management and interest rate hedging. The amount of the annual limit should be calibrated after considering the aggregate impacts of changes to UFR – therefore, we could not comment on whether 20bps is itself appropriate – an impact analysis would be preferable.	