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:	University of Amsterdam (prof. Michel Vellekoop)	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
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Reference	**Comment**	
General Comment	The scope of this consultation is limited to the value of the UFR, but the stated goal of policyholder protection would have been served even better by a consultation on the entire term structure extrapolation procedure. Disadvantages of the current approach, such as inconsistencies with observed market data for liquid maturities and kinks in the nominal yield and forward curves, could then have been avoided or mitigated. This can for example be achieved by using a different method to determine the last liquid point and/or the speed of convergence, or by using methods that have been reported in the academic literature which define the UFR as a weighted average of historical or current forward rates from the liquid part of the curve. A simple special case of the	

	last approach extends the last liquid forward rate to all higher maturities; that method was used by some central banks before the Solvency II extrapolation method was introduced.	
Q1. (pg. 56)	The fundamental assumption underlying the approach proposed in the consultation paper is that forward rates for very high maturities can be reliably estimated as the sum of weighted averages of historical real rates and central banks' inflation targets. But this leads to extrapolated nominal term structures that are incompatible with, for example, current market data for the deep, liquid and transparent part of the euro curve between maturities 20 and 30. This suggests that this fundamental assumption does not necessarily hold under all circumstances. It also suggests that the proposed approach may be at odds with Article 43(a) of the Delegated Regulation, which states that insurance and reinsurance undertakings must be able to earn the rates in a risk-free manner in practice.	
Q2. (pg. 56)		
Q3. (pg. 56)		
Q4. (pg. 56)		
Q5. (pg. 56)		
Q6. (pg. 56)		
Q7. (pg. 56)		
Paragraph 1.		
Paragraph 2.		
Paragraph 3.		
Paragraph 4.		
Paragraph 5.		
Paragraph 6.		
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Paragraph 8.		
Paragraph 9.		
Paragraph 10.		
Paragraph 11.		
Paragraph 12.	To achieve the stated objective, choosing the UFR appropriately is not enough. The choice of the last liquid point and the speed of convergence are equally important if one wants to avoid that insurance undertakings may set up provisions for their long-term obligations towards policholders which are too low.	
Paragraph 13.		
Paragraph 14.		
Paragraph 15.		
Paragraph 16.	Most reported concerns are not focussing on the interest rate for maturities of 60 years or higher but on maturities directly after the so-called last liquid point, for which there is still sufficient liquidity. It is unlikely that the artificially created curve for these maturities, which contains data points which have zero depth and zero liquidity, provides a more accurate estimate of the cost of riskfree cashflows than rates that are based on the fixed income markets in which such cashflows are constantly bought and sold.	
Paragraph 17.		
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Paragraph 35.		
Paragraph 36.		
Paragraph 37.	In papers such as the one by Ang, Bekaert and Wei cited in the footnote for this paragraph, the authors decompose nominal rates into real rates, expected inflation and inflation risk premiums ('term premiums'). But they do not assume that the last ones are zero or that the first two are constant over time. On the contrary, they emphasize that regime shifts can occur which may cause these values to change and they state (at the end of page 832 in their paper): '*We obtain inflation risk premiums of [this] low magnitude only in high real rates regimes and in normal times assign almost all of the positive nominal yield spread to inflation risk premiums*'. That does not correspond to the methodology proposed in the consultation paper.	
Paragraph 38.		
Paragraph 39.		
Paragraph 40.		
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Paragraph 45.		
Paragraph 46.		
Paragraph 47.	When an UFR calculation method based on forward rates results in estimates that are less stable over time, this is not necessarily a disadvantage. Financial risk management implies that one must constantly assess whether changes in the financial markets necessitate an adjustment in current strategies and/or policies. If estimators are used which change only very slowly under the most detrimental circumstances, this may pose a serious risk in the long run. As stated in paragraph 17 of the consultation document: '*It should also be considered that delaying any change of the UFR due to current changes in long-term expectations may result in even more drastic changes of the UFR in the future, in case the long-term expectations have then moved further away from the current UFRs*'. Paragraph 1 of Article 47 in the Delegated Regulation does not quantify the term 'stable' so it should not be used to disqualify alternative approaches in which the inherent uncertainty in long term interest rates manifests itself in the form of fluctuations in estimates over time.	
Paragraph 48.		
Paragraph 49.		
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