# LTGA Findings

1 July 2013

# Process until 14 June

- ToR – Starting Point

- LTGA TF
  - Experts from EIOPA, NSAs, ESRB
  - EU wide effort
  - Other Expert Groups – FinReq, FSC..

- Informed Analysis
  - Listened to Stakeholder views/analysis
  - Elements used where useful

- EIOPA Board of Supervisors
  - Decisions on Key Steps
  - Decisions on Outcomes/Recommendations

# Process from 14 June

- Submission of EIOPA’s report to Trialogue parties on 14 June and publication on EIOPA’s website

- Discussion of LTGA findings with a number Trialogue stakeholders after 14 June

- Next Trialogue steps:
  - First Trialogue meeting planned on 10 July 2013
  - COM report on LTGA expected on 12 July 2013

# General Approach and Principles

- SII framework incl. LTGA should ensure a high degree of policyholder protection as well as effective supervisory processes.

- Full support of underlying Solvency II principles

- Guiding Principles for the Assessment
  - Alignment with the SII framework and the economic balance sheet concept;
  - Full transparency and comparability;
  - Efficient linking of all three Pillars;
  - Proportionality and simplicity; and
  - Adequate treatment of transitional issues.

- Make a positive contribution to assist the Trialogue discussions

# Overview of the LTGA

- EIOPA was asked to test five LTG measures as part of the LTGA:
  1. “Countercyclical Premium” (Art. 77a)
  2. “Extrapolation” (Art. 77b)
  3. “Matching Adjustment” (Art. 77c & 77e)
  4. “Transitional Measures” (Art. 308b)
  5. “Extension of recovery period” (Art. 138(4))

- The measures where tested through a mix of
  - Quantitative and qualitative survey with industry
  - Qualitative survey with national supervisors
  - Additional analyses by EIOPA

- Results of the assessment have been published in EIOPA‘s LTGA report on 14 June 2013

# Main observations & advice
# 1. CCP

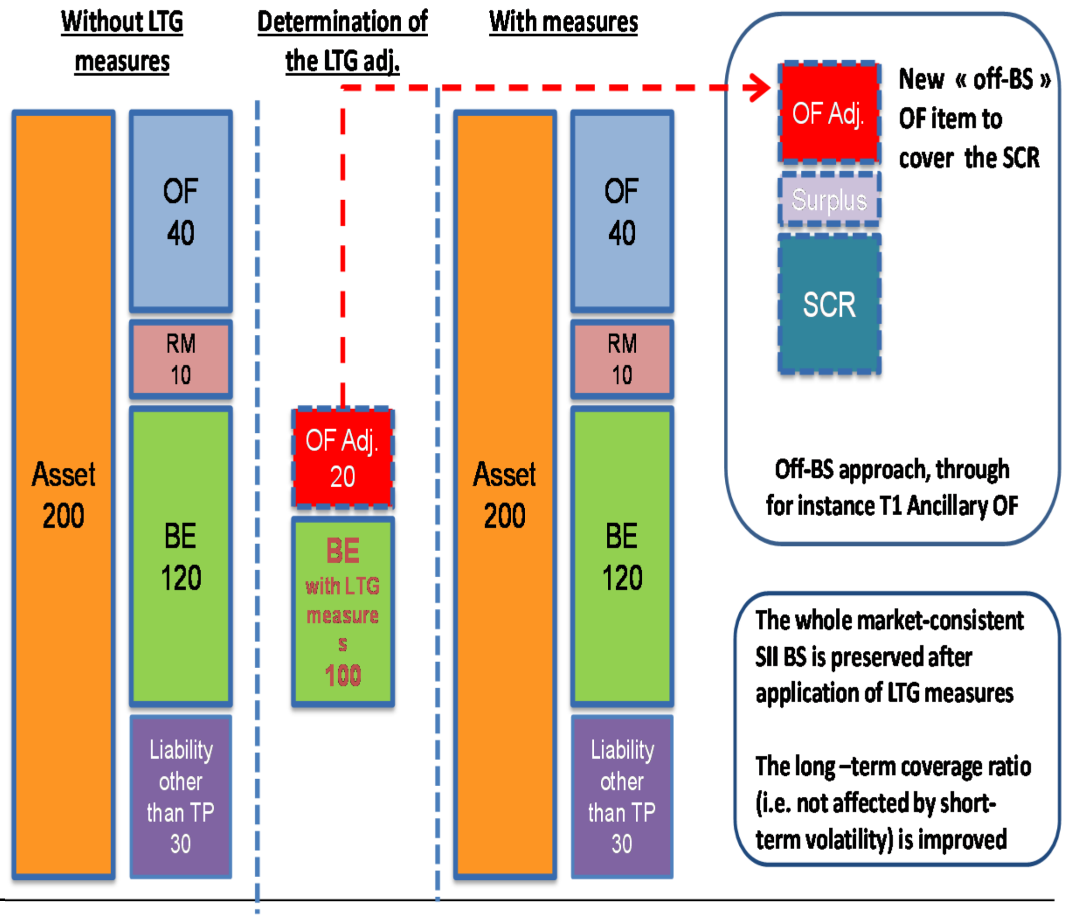
- Main observations:
  - Technically effective to reduce volatility on OF
  - Reduced effectiveness on SCR ratios due to SCR risk calibration
  - Issues related to the triggering process

- EIOPA’s advice:
  - Replace the CCP with a predictable volatility adjustment mechanism (“Volatility Balancer”)
  - Highlights of the Volatility Balancer:
    - Permanent (subject to regulatory review in line with entire LTG package)
    - Based on representative asset portfolio of (re)insurers
    - Currency specific with national top-up in exceptional market circumstances
    - Applicable to all insurance obligations apart from unit-linked
    - Might turn negative under certain conditions (similar to MA)
    - Pure Own Funds adjustment (no impact on capital requirements or technical provisions)

# Volatility Balancer

- Currency-specific reference portfolio is used as a basis (in line with LTGA CCP approach), but reduced application factor as risks, etc. need to be accounted for
- In exceptional situations, VB contains a national-specific top-up
- Reference calibration by EIOPA:
  - o Based on CCP portfolios and relevant spread portions
  - o 20% application factor
  - o National top-up if VB exceeds 2x currency VB

- Visualisation of the Own Funds adjustment:



# Main observations & advice
# 2. Extrapolation

- Main observations:
  - Shorter convergence period generally results in more stability of technical provisions, but not OF
  - Shorter convergence period results in potential delink of the extrapolated part from financial market reality with negative consequences for
    - Risk management of the undertakings (e.g. misevaluation of options and guarantees)
    - Consistency within regulatory processes (e.g. with respect to ORSA and internal models)

- EIOPA’s advice:
  - Select a convergence period that is significantly longer than 10 years (e.g. 40 years) for the Euro
  - For other currencies, the characteristics of the local bond and swap markets must be taken into account
  - Dedicated pillar 2 measures such as sensitivity analysis

# Main observations & advice
# 3. Matching Adjustment

- Main observations:
  - o Very complex measure (undertaking specific)
  - o Restrictions on assets and liabilities are need to prevent false risk management incentives

- EIOPA's advice:
  - o For the Classical MA, include the strict criteria relating to CQS 3 investments (i.e. the 33% portfolio limit excluding government bonds and the MA cap) plus implement some minor amendments to the measure:
    - inclusion of immaterial mortality risk;
    - ability to manage the credit quality of portfolios in case of downgrade risk;
    - maximum levels of MA for CQS 3 investment to be provided by EIOPA;
    - appropriate criteria and conditions via guidelines to deal with "cliff effect situations" to be provided by EIOPA
  - o For the Extended MA, exclude it from the LTG package

# Main observations & advice
# 4. Transitionals

- Main observations:
  - Positive effect regarding policyholder protection, if adequately controlled via supervisory review process
  - Tested measure only works in selected Member States

- EIOPA's advice:
  - Implement Transitionals
  - Accompany tested Transitional with another measure that can address different issues
  - Both measures to result in Own Funds adjustment only (no impact on capital requirements or technical provisions)

# Main observations & advice
# 5. Extension of Recovery Period

- Main observations:
  - Useful tool for supervisors in times of market distress
  - Currently, application limited to "steep fall in financial markets", therefore low IR crisis could not be addressed
  - Strict and sole link of the measure to the duration of liabilities might reduce the general efficiency of the measure (e.g. can only be applied to liabilities with duration > 12 years)

- EIOPA's advice:
  - Keep the measure, but extend it to provide possible pillar 2 solutions for other sort of crisis situations
  - Reduce the strict link to liability duration
  - 7 years extension should be a maximum

# Main observations & advice
# 6. Complexity & Transparency

- Main observations:
  - LTG package is very complex in terms of implementation and results interpretation

- EIOPA advice:
  - Introduce full transparency (i.e. public disclosure) of the impact of the LTG measures
  - Implement OF adjustment approach for Transitional and CCP alternative, as these two measures do not directly relate to the economic reality of the undertakings

# Main observations & advice
# 7. Single market & Consistency

- Main observations:
  - Several tested LTG measures represent Member State options and explicitly excluded cross-border business from their application
  - Furthermore, non-life and reinsurance business is explicitly excluded from the application of selected measures, e.g. the MA
  - These exclusions do not seem to be based on technical or prudential reasons where the application conditions are otherwise met

- EIOPA's advice:
  - No link of LTG measures to Member State options and no exclusion of cross-border business from any measure (apart from the exceptional national top-up to the Volatility Balancer)
  - Principle of substance over form should be fully incorporated in the LTG package