
## Background

- Treatment of Long Term Guarantees is a key issue to progressing Omnibus II
- Trilogue concerned that Solvency II could lead to 'artificial volatility' & pro-cyclicality without Long Term Guarantee measures
- Could lead to range of unintended adverse social and economic impacts:
  - Shift from longer-term to shorter-term assets
  - Move away from offering long-term guaranteed products
  - Cost of overly-high capital requirements passed on to customers
  - Limit insurers' traditional role as investors in the European economy
  - Reduce insurers' traditional role as a stabiliser of systemic risk and market volatility

## Impact Assessment

- Trilogue decided in July 2012 that LTG package should be subject to impact assessment
- Scope and content of LTGA developed over H2 2012
- Participation per country
  - 50% life insurance by technical provisions
  - 20% non-life by premiums
  - Representative undertakings
- In Ireland, ca. 6 (re)insurers participating



## Timelines

| 28 Jan 2013 | 31 March 2013 | 14 June 2013 | 12 July 2013 |
|---|---|---|---|
| Impact assessment launched | Deadline for undertakings to submit results to supervisors | EIOPA to submit findings to EU Commission | Commission report to co-legislators |

## The long-term guarantees 'package'

- Extrapolation of risk free yield curve
- Matching adjustment (MA)
  - Classic
  - Extended
- Counter-cyclical premium (CCP)
- Transitional provisions
- Extension of recovery period




## Scenarios tested

- Base scenario
  - Extrapolation similar to QIS5 but ultimate convergence is earlier
  - Assumes no CCP, no MA, no transitionals
  - Reference date is 31 December 2011
- 12 other scenarios covering:
  - Two alternative extrapolation methodologies
  - CCPs of 100bps, 50bps and 250bps
  - 2 versions of classic MA and 3 versions of extended MA
  - Transitional measures (existing business vs. paid in premiums)
  - Reference dates of 31 December 2009 and 31 December 2004
- Additional sensitivites required for some scenarios

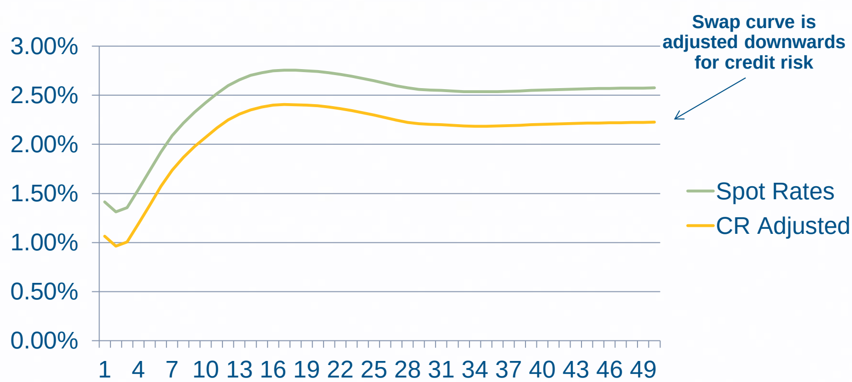
# Extrapolation

- Swap curve is starting point, adjustments then made for:
  - Credit risk
  - Market rates used up to Last Liquid Point ('LLP')
  - Convergence after LLP to Ultimate Forward Rate ('UFR')

- The impact on LTGs will be sensitive to the choice of parameters (base scenario assumptions shown in brackets):
  - Credit risk (35bps)
  - Choice of LLP (30 years)
  - UFR (4.2%)
  - Convergence period 'CP' (40 years)

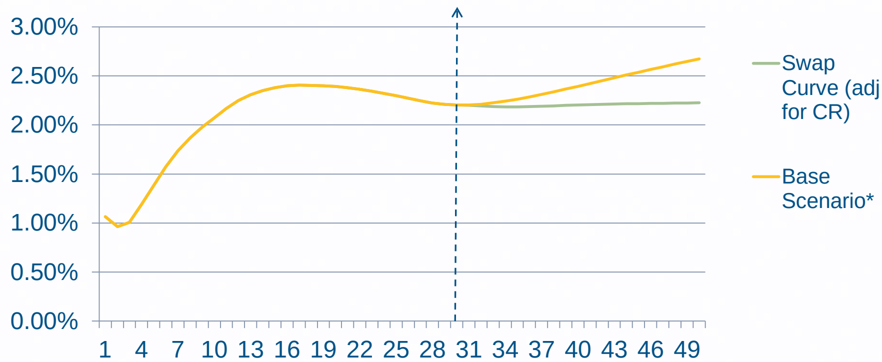


# Euro swap rates at 31 December 2011



# Extrapolation – base scenario

**Last Liquid Point ('LLP') based on QIS5 LLP of 30 years**




*** LLP of 30 years, 40 year convergence period, UFR of 4.2%**

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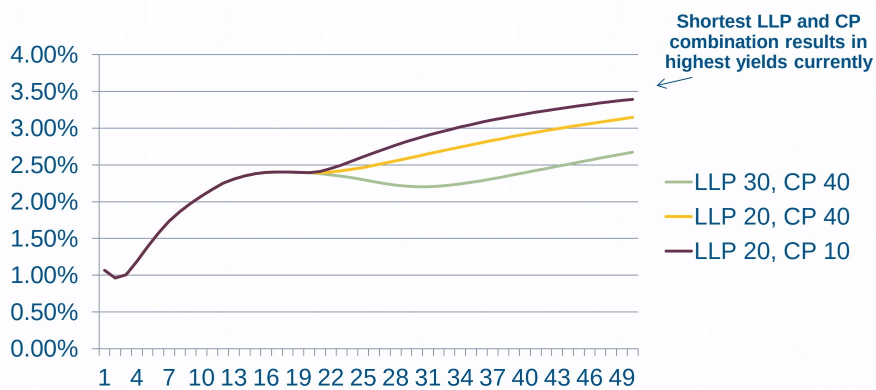
# Extrapolation – 3 scenarios investigated

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## Extrapolation of yield curve

- Aim is for stable longer term rates to avoid ‘artificial volatility’ in calculation of TPs
  - – However, at odds with ALM and hedging on an economic basis
- Will apply to both domestic and cross border business



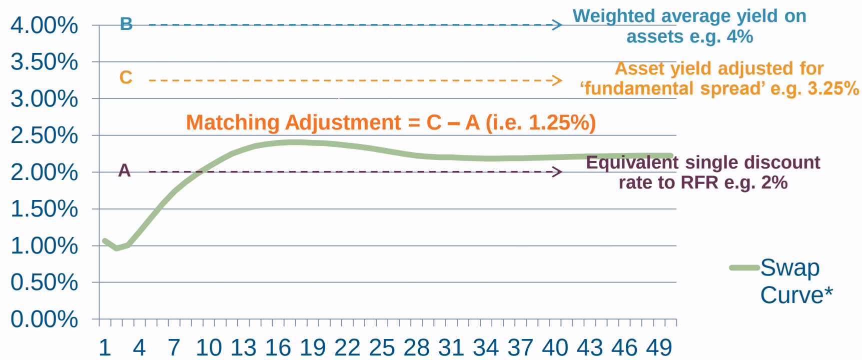


## Matching Adjustment

| | Classic | Extended |
|---|---|---|
| Versions | - Classic Standard<br>- Classic Alternative | - Extended Standard I<br>- Extended Standard II<br>- Extended Alternative |
| Product restrictions | - Excludes unit-linked<br>- Cannot surrender for more than asset value<br>- No future premiums | - Excludes unit-linked<br>- Can include policyholder options |
| Asset credit limits | - BBB limit of 33% for Standard version, none for Alternative | - BBB limit of 33% for Standard versions, none for Alternative |
| Sample products | - Immediate annuity | - With-profits products |

- Cross border business excluded from scope under previous proposals
  - – LTGA technical specification silent on this issue

## Matching Adjustment – Calculation Step #1




* Swap curve at 31 December 2011 adjusted for credit risk



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## Matching Adjustment – Calculation #2

| | Classic | Extended |
|---|---|---|
| Fundamental spread | Floor is 75% of long term average spread | Floor 80% of long term average spread for Standard versions, no floor for Alternative version<br><br>Excludes cost of downgrade element for Alternative version |
| Application ratio* | 100% | < 100% (formula prescribed) |

* Proportion of calculated amount from previous slide that can be used



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## Countercyclical premium

- Applies to business not eligible for matching adjustment
- Envisaged that CCP will be temporarily introduced when markets are stressed
- Envisaged that EIOPA will play a leading role in deciding when CCP introduced and how much
- (Re)insurers will have to disclose use and financial impact
- Expected to apply to both domestic and cross border business



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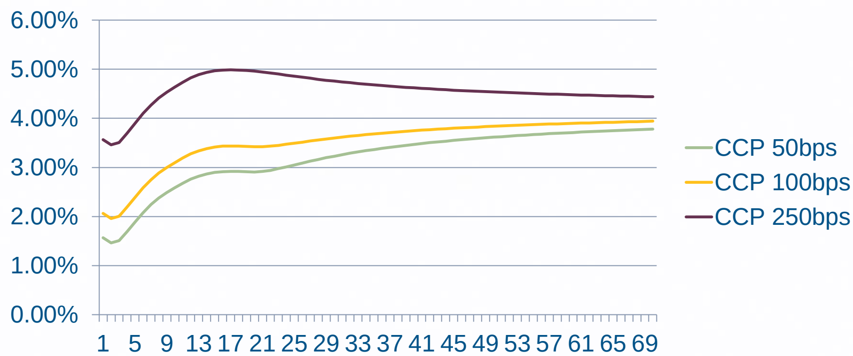
## Risk free curve plus CCP



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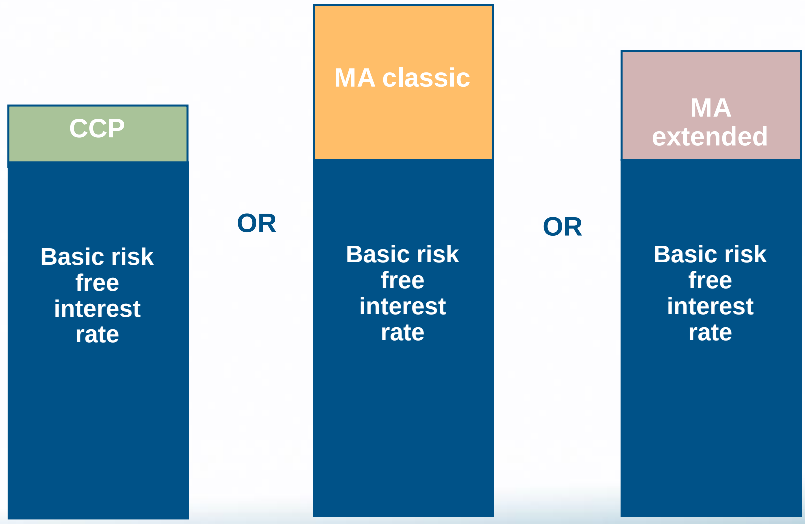
## CCP/MA by line of business

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## Transitional measures

- Proposed blending from Solvency I interest rates over 7 years
  - Weighted average of Solvency I and Solvency II interest rates
  - Weighting for SI rate is 100% reducing to 0% over 7 years
  - Weighting for SII rate is 0% increasing to 100% over 7 years
- Equity stress set at 22% for all equities
- No extended matching adjustment where transitional measures applied
- Can only be applied to domestic business and not cross boder business

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## In Conclusion

- Resolution of LTGA package is key to progressing Omnibus II
- Key open issues include:
  - How early will full extrapolation of the curve come into effect?
  - What credit limit restrictions will apply to the Classic MA?
  - If an Extended MA is introduced, how will the ‘Application Ratio’ be calculated, what restrictions will apply to credit limits and fundamental spread?
  - Under what conditions will CCP be introduced or removed?
  - What transitional provisions will apply?



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## In Conclusion

- Package of measures is more important for some countries and some lines of business e.g.
  - Exrapolation and CCP important for German industry
  - Matching Adjustment important for UK annuity industry
- However some measures will impact all companies
  - Extrapolation
  - CCP
  - Extension of recovery period
- Concerns exist if some measures limited to domestic business



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