Matkaraportti EIOPAn Long Term Guarantees (LTG) laskentaharjoitus käsittelevistä kokouksista 25.7.2012, 21.9.2012 sekä 11.1.2013

Osallistuin Groupe Consultatifin edustajana EIOPAn järjestämiin epävirallisiin kokouksiin, jossa keskeiset etujärjestöt kokoontuivat keskustelemaan tammikuussa 2013 järjestettävän LTG-pakettia käsittelevän laskuharjoituksen sisällöstä ja tavasta toteuttaa se. Seuraavassa on kohta-kohdalta raportti kustakin kokouksesta:

25.7:

Timing/Process/Coverage/Scope

- Gabriele Bernardino started the meeting by issuing a rousing "call to arms" to be pragmatic and get agreement on LTGs etc. He then immediately left the meeting.
- The meeting was chaired by Anne Froehling (who did a good job). She said this was all last minute and EIOPA had to provide some feedback to the EC by this Friday (27 July).
- She asked whether the actual study could be carried out within 8 weeks and there was no general disagreement from participants (other than caveats on how much work had to be done).
- There was strong pushback on the proposal that 30.6.12 data would be used for a number of reasons (unaudited data, poor quality response, market conditions reasonably favourable). The preference was for 31.12.2011.
- Industry was keen that the stress tests would capture market conditions in the past (i.e. those that had contributed to the balance sheet volatility)
- EIOPA plan to issue a specification for the calculations so that participants will know "which version of SII to use"
- There will also be a Q&A process similar to QIS5
- It is likely that all of the above would be ready by September. Industry were keen to be involved in all stages of the process rather to than to have a completed spec dropped on them in September.
- The actual submissions to be completed were likely to "SI coverage" and SII coverage (TP, SCR, Own Funds).
- It is likely that unapproved internal models can be used instead of the standard formula.
- All companies will have to participate (even those not affected by LTG issues)
- EIOPA will be looking for the actual calculations (cashflows etc.) for the matching premium from each company so they do their own analysis [sounds onerous]
- There may be some proportionality where smaller companies may only have to submit a matrix of numbers or a subset of scenarios.
- Industry noted that this would be a substantial diversion from SII preparations. They were also concerned that this might hold up SII or the conclusions may not be reflected in SII if Trilogue moves faster than the study.

Matching Adjustment (Large portion of the meeting)

- Debate about whether the final "}" in slide 13 was in the wrong place – should be after "FS" in the formula.
- Slide 13 referred to the fully matched position only.
- Industry said that they would provide some examples and Anne asked that these should be submitted by Friday (i.e. tomorrow) as they were under severe pressure.
- EIOPA will produce a table for "fundamental spreads" by class of asset, rating, duration, currency. Companies would use the table to determine the fundamental spread.
- Big debate about what to do where assets were shorter than liabilities (industry suggesting pairing off assets with liabilities and what ever was left over would be subject to lapse shock).
- There was discussion as to whether FRNs and callable bonds should be included in the list of assigned assets (slide 17).
- There was a suggestion from industry that "ring fenced" was too strong and it should be looser ("intention to hold assets to maturity")
- Industry suggested that the acid test of qualifying matching premium was "forced to sell"/"not forced to sell".
- Industry disagreed with the EIOPA approach to predictability (slides 20, 21, 22) and suggested that the monetary amount of the matching premium should be pro rated by the PV of the stressed liability/PV of the unstressed liability.
- Simplified approaches may be allowed for smaller companies.

Transitional Measures

- Industry not overly keen to test this as not a priority.
- They also suggested that alternatives should be tested (again asked to submit alternatives by tomorrow Friday)

CCP

- EIOPA had come up with a new formula and stressed that the parameters were samples only and welcomed input.
- The proportions (in slide 30) were going to be based on average industry asset weightings.
- Interestingly they said that national supervisors will be allowed to trigger CCPs so there may be a pyramid of EIOPA, national supervisors, different markets etc. of CCPs on the go at any one time (effectively country specific yield curves! Back to pre Euro days!)
- Issues raised by industry :
    - Should they or should they not be allowed anticipate the CCP (e.g. in management actions – selling assets)?
    - May influence behaviours (pro cyclical)
    - How would the pyramid work?
    - The "cliff" effect (if CCP withdrawn and effect on solvency).

Extrapolation

- Again not much enthusiasm for testing this.
- Separately there was a preference that the UFR should stay constant for long periods and only be adjusted by small steps (10bps) in the future.

In summary, EIOPA seem to have a lot of work to do and have to think through a lot of the issues. August could be a busy month for them. We would hope to see the various iterations in their thinking before the final spec is issued.

Lauri/Colin.

21.9:

- General
  - The main discussion was about the impact assessment which aimed to focus on solo undertakings (groups are combined by national supevisors), the stress test part (chapter 3 in the presentation) was one hour discussion in the end.
  - Lars Dieckhoff commented little bit what was the issue in the trialoque-meetings. It was discussed whether the LTGA should be ex-post or ex-ante type of assessment. Ex-post would mean that first OmnII would be closed then test it via the LTGA and ex-ante that the LTGA would actually test different OmnII versions (legal texts) and Omn II would be approved after the test. During the following discussion it became quite clear that ex-post was the general idea and that was the reason the LTGA was designed at the start as it was. Ex-ante probably being more likely outcome would make it possible to produce more different LTGA (for instance more tests or different approaches). Industry proposed that the reporting burden (as mow detailed information to report) should be reduced but it could be possible to calculate many more scenarios with different parameterizations. A trialoque meeting to take place at the beginning of October, here it should be closed whether it should be ex-ante or ex-post.
  - 2011 reference date was to be used in every scenario. Year 2004, 2008, 2010, etc. had the difference that the euro-swap and spread yields were at a different levels. 2011 balance sheets wouldn't change necessarily for other reasons when adjusting to certain date.
  - Internal model could be used even of not approved for 'whole way the process'.
  - EIOPA to send proposal to industry about the LTGA before 28th September, and industry has one week to comment.
- CCP
  - Representative portfolio is by each country. This makes the level of CCP different for each nationality and also less important for some nationalities than others. The measure was unclear, Merrill Lynch index family was discussed but would the CCP depend on some average of how the companies invests or what the general level of the national gov. and company bonds are, don't know?

- For industry perspective testing CCP was somehow needless. As long as there is a trigger that EIOPA holds one can't trust on the existence when needed.
- Extrapolation and credit risk adjustment (CRA)
  - Surprisingly Lars told that it was actually never agreed in the trialogue-discussions that the 40 year extrapolation period was of the table. This was the reason for the need to test this.
  - CRA was quite much discussed and the industry point of view was that this actually did measure the bank defaults.
  - CRA doesn't affect the UFR but can make the net adjust negative if for example CCP is +30bps and CRA is -50bps (=euroswap – 20bps).
  - From industry side scenario where CRA=0 was asked to be tested
- Transitionals
  - In the EIOPAs proposal no CCP was applied in the transitional period
  - The whole interest rate curve was to be differentiated in the transitional period (not just e.g. 1 to 20 year swaps)
  - There was a concern about the end effect to SCR interest risk because the liability side int. risk would diminish leaving the asset side risk the same this would increase the end int. rate risk quite much eating a significant bite of the EOF got after discounting with transitionals
- MA
  - Both mortality and morbidity probably will be counted in when defining the constraints for liabilities. There was a discussion and both EIOPA and Lars were kind of allowing for this
  - Industry raised a question about the definition of allowable assets. Now both floating rate bonds and swaps are not counted as eligible assets both when combining them a company would actually produce fixed cf's. EIOPA took this under consideration
  - EIOPA had acknowledged that they actually should define here what even is a asset
  - There was quite intensive discussion about EIOPA going to leave the definition of the 'ring-fenced or managed separately…' out of scope in the LTGA. From industry point of view it was crucial to get answer to this point because else the result of the LTGA would be misleading. This would also burden the national FSA's when trying to mirror this to national legislations
  - Industry accentuated that the risk behind MA should be forced sales not e.g mortality or disability itself
  - From industry point of view A&L mismatches should not be look at year-by-year basis
  - Didn't have time to cover whole MA issue EIOPA to organize phone conf. @ 10-12 CET next Wednesday.
- Stress test
  - Seemed to be far less important issue
  - There was a talk should it be done in Q4 2013 or in Q2 2014 and basing to which reference date. EIOPA did suggest ref.date of 30.6.2012 but industry was not too happy about this. CRO- and CFO forum to answer the Q4/Q2 question next Wednesday

Lauri.

11.1:

Main Points

- EU Commission consider to including “cash” in the MA and application ratio. It may be a separate scenario.
- EU Commission to also consider allowing swaps in combination with an inadmissible asset (so on the whole, would be considered to be admissible e.g. floating rate note plus swap). May be a separate scenario.
- Debate about whether the “matching adjustment” was about matching or “forced sales” (i.e. if you had assets up to 20 years and liabilities for 50 years, would or would it not qualify?)
- EU Commission not keen on hypothetical portfolios (i.e. portfolios that weren’t exactly matched at end 2011 but could be matched if the rules were known). However there was sympathy for submitting results demonstrating where the “admissibility” rules worked.
- EU Commission agreed to consider the fact that contracts with immaterial mortality risk should also be included in 77(c). They recommended unbundling as a first step.
- The rules used for determining the matching threshold (e.g. 10%) etc would be translated into principles for L2.
- Point of interest : Confirmed that there is no “look through” if assets wrapped in SPVs.

General

- When LTGA starts all the questions should be addressed to national FSA’s
- Companies are allowed to provide answers even if not all of the scenarios are finalised
- With the reporting templates it should be kept in mind that this is best effort basis since some of the requests are bit onerous
- EIOPA will clarify how to calibrate ESG’s in CCP and MA calculations but it looks like it will be same as the discount rate.

CCP

- For clarification CCP will be added to Euro Swap spot curve (until the last liquid point)

Transitional measures

- Transitionals will apply only to life business
- There was a discussion about how to apply transitional measures into fixed SI discount curves and how to calibrate ESG’s in those calculations, e.g. the problem of zero discount curves was discussed. EIOPA did accentuate the general principle that same assumption about future returns should be assumed both in asset and in

liability side. So if company uses 2% SI discount rate, also the asset side should be calculated assuming the same rate. EIOPA will clarify this point.

- EIOPA noted that the assumption to calculate SCR by stressing both SI and SII discount curve can be controversial depending whether SI rate is based on market curve or is fixed

MA

- The main issues were filtered out and discussed with Lars Dieckhoff (EC) in a conf call at the end of the meeting
    - Exclusion of negative annual net cash flows. Since this has a substantial effect into the application ratio it was agreed that both allowing and not allowing these would be tested somehow in the assessment
    - Allowing for cash as an asset in MA. It was agreed to consider taking cash part of the assets being held in MA.
    - Adding immaterial mortality risk into 77c. Since mortality risk was inside 77e this was not allowed. EIOPA clarified that (under ToR) companies do have the option to split policies into different risk categories and use 77c where it applies
    - Treatment of swaps as admissible assets. EIOPA and EC to try to come up with a solution

- Other issues discussed under different calculation steps
    - Step 2. It was noted that where there was optionality in bonds, the assets were inadmissible. There was a discussion around how issuer options and other optionality in bond investments should be interpreted as there are different regulations in different states. This may exclude large asset classes such as RMBS (with early repayment options) which would be problematic. Also, new EU government bond issues are now issued with "collective action clauses". This could render EU government bonds inadmissible (although personally I thought that all this falls under "default").
    - Step 2. Swapping fixed-to-fixed cashflows seemed to be ok for EIOPA
    - Step 2. Some non-admissible assets might become admissible if there was a SPV between these assets and the bond. Interesting in that there is no "look through".
    - Step 3. The 10% shortfall limit that was set seemed to be quite low but this was just for LTGA purposes. EIOPA told that in the final Level 2 they want to do something more principal based approach.
    - Step 3. The industry representatives suggested EIOPA to use a value approach rather than a discount approach in MA (the effect should never be greater than the value of the spread on the assets). The two important aspects of MA was also noticed; the improvement of the level of own funds and the way it reduces the volatility of own funds
    - Step 4. EIOPA's examples for calculating MA are just examples. They were trying to apply the same principles as in the legal text so one should defer to the text.

- EIOPA won’t be producing fundamental spreads below triple B level. Company’s should estimate these by themselves (and submit them as part of the response).