Public Consultation. Technical Documentation on the Relevant Risk Free Interest Rates Term Structures

End of the period for comments: November 21st, 2014 (noon, CET)

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Name of the Stakeholder IRSG

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num	Section	Page	Paragraph	Priority	Comment	Control
1	General comme	1	1	High	The IRSG welcomes EIOPA's commitment to consultation on the technical specifications underlying the quantitative parameters which it is required to calculate and to publish under Solvency II, namely risk-free rate term structures, volatility adjustments and the risk corrections and fundamental spreads for the purposes of calculating matching adjustments. We appreciate the proactive effort which EIOPA staff have made to canvass stakeholder opinion during the process of formulating the technical specification.	
2	General comme	1	1	High	Nevertheless, the consultation draft retains many ambiguities particularly in respect of volatility adjustments and risk corrections and fundamental spreads. The period for consultation is extremely short at three weeks. It has to be acknowledged that reliable market data simply may not be available to meet the detail of the volatility adjustments and risk corrections and fundamental spreads. This is not at all a criticism of EIOPA which has been constrained by both the long drawn out Omnibus 2 process and the Solvency 2 implementation timetable.	
3	General comme	1	1	High	Furthermore the consultation draft is conceptual and does not include any illustrative backward-looking results (for the good reason that reliable data sources have not yet been identified).	
4	General comme	1	1	High	**Potentially anomalous outcomes**	
5	General comme	1	1	High	For all the foregoing reasons, it is surely prudent to anticipate that some anomalous results will arise when the proposed approach is implemented in the preparatory phase from February 2015 onwards. It is to be hoped that these will be peripheral in relation to the EU insurance industry overall, but they may well be very significant for affected countries, currencies or undertakings.	
6	General comme	1	1	High	The IRSG therefore suggests that EIOPA in conjunction with national supervisors should proactively monitor implementation with a view to learning quickly of potentially anomalous outcomes. These should be assessed and it should be considered whether the methodology should be revised.	
7	General comme	1	1	High	It is possible that anomalous results in respect of volatility adjustments and risk corrections and fundamental spreads may arise only in conditions of stressed markets. For this reason it is desirable that backward-looking results be calculated especially covering year-ends 2008-2011 inclusive and that any implications for the methodology be digested well in advance of 1 January 2016.	
8	General comme	1	1	High	**Data availability / reliability**	
9	General comme	1	1	High	The definition of the volatility adjustment particularly and to a lesser extent that of the risk correction and fundamental spread assume availability of reliable market information at quite a granular level. It remains to be seen whether such information is available and whether it is continuously reliable. Should this not be the case, some work-arounds are likely to be feasible (some of these are already envisaged in the document as it stands) and it will be important that these are devised and tested in consultation with stakeholders. The IRSG particularly notes that the asset class embracing fixed-income debt other than government bonds is very heterogeneous to the point where reliable indices at country level will be a real challenge. The approach which may be taken by undertakings to countries/currencies not considered to justify publication of parameters by EIOPA also needs to be clarified. More positively, it seems likely that data availability should improve in 2017 following Mifid 2 implementation.	

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num	Section	Page	Paragraph	Priority	Comment	Control
10	General comme	1	20	High	**Market depth, liquidity and transparency**	
11	General comme	1	20	High	The IRSG strongly commends paragraph 20 of the consultation and in particular the envisaged gradual approach to revision of the DLT assessment. Although in the real world liquidity can change quite rapidly particularly in peripheral or emerging markets, stability will be well served by a bias against over-reaction in revision of the DLT assessment.	
12	6.D. Ultimate fo	1	37-41	High	**Ultimate forward rate**	
13	6.D. Ultimate fo	1	37-41	High	The IRSG supports in principle the thinking about the 'ultimate forward rate' summarised in paragraphs 37 to 41 inclusive of the document. It acknowledges that there are arguments in favour of a single 'bucket' but given the perhaps short convergence periods imposed by legislation three 'buckets' probably are to be preferred. There are however dangers in assuming that the relative inflation characteristics of economies do not change and the position therefore should be kept under review from time to time.	
14	General comme	1	1	High	**Local government debt**	
15	General comme	1	1	High	As an example of the heterogeneity of fixed-income debt other than government bonds, the document is silent on the subject of local (e.g. municipal) government debt as a distinct asset class. This asset class has significance in some countries and for some undertakings. It is often not rated in the same way as other types of debt asset (see below). It is probable that further consideration will suggest elaboration of the methodology to accommodate characteristics of this class.	
16	8.E. Reference	1	1	High	**Reference portfolio weightings**	
17	8.E. Reference	1	1	High	The IRSG sees the composition of the reference portfolios for the purpose of calculating the volatility adjustment as an issue requiring a good deal more analytical work. It seems likely to be necessary to gather more data on the past mix of assets at a currency/country level. Variations between countries and over time need to be better understood in order to consider how a reference portfolio truly should be deemed to be constituted. The approach of combining retrospectively assessed weights with current market information does not commend itself, although it may be the only one practicable. Consideration should be given to whether it is possible to derive plausible current weights from past information or alternatively whether more stylised weights changing only intermittently should be used. The approach has to be able to be applied to US dollar and some other major non-EEA currencies somehow. Unit-linked business should be unambiguously excluded throughout.	
18	General comme	1	1	High	**Aggregation of risk corrections**	
19				High	There is an element of double-counting in the probability of default and the cost of downgrade such that the tota	All columns should be filled in
20	General comme	1	1	High	There is an element of double-counting in the probability of default and the cost of downgrade such that the total is higher than the expected total cost of adverse credit development over the life of the relevant asset portfolio. This has the potential to distort investor behaviour in a way which were better avoided.	
21	General comme	1	1	High	**Unrated assets**	
22					The implications for investment behaviour of the approach by EIOPA to classify unrated assets as 50% CQS3 a	All columns should be filled in

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num	Section	Page	Paragraph	Priority	Comment	Control
23	General comme	1	1	High	The implications for investment behaviour of the approach by EIOPA to classify unrated assets as 50% CQS3 and 50% CQS4 need more careful consideration. We understand this is intended as a practical rationalisation but it would be better based on consideration of the underlying credit characteristics of this asset country by country. Several unrated asset categories (for example residential mortgage loans and infrastructure debt) do have a credit quality which is generally better than the suggested 50%. The suggested percentages could lead to a disincentive to invest in these kinds of investment categories and therefore need a more careful approach. At a minimum the resulting mix by credit quality step should be published.	
24	General comme	1	1	High	**Other matters**	
25	General comme	1	1	High	• The legal status of the technical document, the timeliness of the updating process, and the respective roles of the Commission and EIOPA at outset and on an ongoing basis all need further clarification.	
26	General comme	1	1	High	• The implications of the expected initial February 2015 initial publication timetable need to be clarified such that internal model application filings prepared prior to such initial publication are not invalidated.	

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