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Belgium
Financial Services

Solvency II
EIOPA - Results of the Long Term Guarantee Assessment

Dear Madam,
dear Sir

As you may have noticed, EIOPA published on June 14 the results of the Long Term Guarantee Assessment. This is a critical step in the Solvency II regulatory process: as a reminder, the LTGA was commissioned to assess options to deal with contentious issues hindering the finalization of the Omnibus II directive. Assuming that the European institutions agree on the outcome of the LTGA, this would open the way of the adoption of Omnibus II by the end of this year, making possible an implementation of Solvency II by 2016.

The results are EIOPA's advice to the European Commission, the European Parliament and the European Council – the institutions which will have to agree on the final Omnibus II directive.

On the basis of the assessment and the outlined principles, EIOPA supports the inclusion of some of the measures tested, with slight amendments to provide the right incentives for sound risk management:

- **Extrapolation:** EIOPA advises to select a convergence period that is significantly longer than 10 years (e.g. 40 years) for the Euros. Furthermore, in order to reduce potential unwanted consequences of the parameter choice for extrapolation, dedicated Pillar 2 measures should be applied.

- **"Classical" Matching Adjustment":** EIOPA advises to implement the "Classical" Matching Adjustment including the strict criteria relating to the credit quality of investments. Furthermore, EIOPA suggested some minor amendments to the measure.

- **Transitional measures:** EIOPA advises to implement transitional measures as part of the LTG package. In order to make these measures available for a broader application, EIOPA also advises to complement the tested measure with a second measure that is able to address further issues also related to the different valuation of technical provisions under Solvency I versus Solvency II.

- **Extension of the Recovery Period:** EIOPA advises to implement the Extension of the Recovery Period. However, the strict and sole link of the length of extension to the duration of liabilities seems to be too simple given the multitude of factors that determine the decision for the application of the measure. Furthermore, the proposed maximum length of extension needs further review, but should not go beyond the currently proposed 7 years. EIOPA further advises to consider a broadening of the triggers to the measure which would enable an application in crisis situations that are not directly linked to a steep fall in financial markets, e.g. low interest rate crisis or even a combination of major insurance risk events.

EIOPA advises:

- To exclude the so-called Extended Matching Adjustment on the basis that it would not provide sufficient policyholder protection and would be unduly difficult to supervise.

- To replace the Counter-Cyclical Premium (CCP) with a simpler, more predictable measure, the **Volatility Balancer**, which would deal with the unintended consequences on undertakings' capital requirements of short-term volatility. The CCP was judged to be likely to have an adverse financial

stability impact due to the way it would be triggered, as well as the perverse impacts on undertakings' solvency requirements that it generated.
The Volatility Balancer (VB) would be designed to deal in a predictable and permanent way with the unintended consequences of volatility. The VB would be simple, supervisable and comparable, applicable to all insurance business except unit-linked (and unless the business applies Matching Adjustment). It would be calculated as a predictable adjustment to the relevant risk free rate - to deal with competition distortions within the single market. It might turn negative under certain conditions; however, this will depend on the final calibrations of the device.

Finally, EIOPA recommends that the impact of the application of the measures on the solvency position of individual undertakings be publicly disclosed as part of the normal disclosure process.

With my colleagues at Deloitte, we stand ready to answer any questions you may have and will be happy to discuss the implication of this proposition to your business.

Best regards

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