Belgium | FSI Insights | 19 April 2017

Revised UFR methodology

EIOPA clarification

Deloitte Belgium welcomes the clarification brought by EIOPA in publishing the revised Ultimate Forward Rate (UFR) methodology and stresses the importance of informed decision making regarding the impacts on insurers' balance sheet.

On 5 April, the European Insurance and Occupational Pensions Authority (EIOPA) published the methodology to derive the UFR and its implementation process. On announcement EIOPA declares that:

- The principles of the methodology are defined in the Solvency II legislation
- A clearly specified methodology for deriving the UFR is a legal requirement
- The methodology will be applied for the first time at the beginning of 2018
- In line with the methodology, the calculated value of the UFR for the euro is 3,65%
- Annual changes to the Ultimate Forward Rate will not be higher than 15 basis points
- The Ultimate Forward Rate applied to the euro will therefore decrease in 2018 from 4,2% to 4,05%

Deloitte Belgium believes that this revised methodology ensures that the UFR is calculated in a transparent and replicable manner which is good for enhancing risk management practices within insurers' organisations. Based on expected real rates and expected inflation rates, this methodology remains in line with the Solvency II regulation.

Igotz Aubin, Director at Deloitte Belgium comments that "EIOPA's decision to decrease the UFR from 4,2% to 3,65% (for the euro) will mostly impact insurers underwriting long term business". He explains that "this impact results from the decrease of discount rates that in turn will increase technical provisions. It will particularly have an impact on projections included in companies Own Risk and Solvency Assessment (ORSA) if these scenarios were not yet foreseen".

Mechanically indeed, a lower UFR results in lowering the discount curves from the last liquid point (20 years for the euro) until the end of the convergence period (40 years for the euro) and beyond. The annual 15 basis points threshold and phase-in approach however helps the transition from the current UFR at 4,2% (for the euro).

That being said, he argues that "companies have now a clear methodology that rely on robust data set maintained by the European Commission to derive the expected real rate, that can be used to enhance risk management practices and make informed decisions". He adds that "companies will likely take specific management actions further to this change".

Further to EIOPA's announcement, Deloitte Belgium is also commenting that:

- Although there is some economic logic to revise the UFR considering the current low interest rate environment, it is difficult to make predictions that the current low interest rate environment has an overall impact on long-term expectations at this point in time. Changing the UFR now may be perceived conflicting with the Solvency II Delegated Regulations that states that "for each currency, the ultimate forward rate referred to in paragraph 1 of Article 46 shall be stable over time and shall only change as a result of changes in long-term expectations". (Article 47(1)).
- The UFR is part of the Omnibus II package and changing the UFR now likely results in the Solvency II framework being more conservative in the current low interest rate environment.
- The reaction from the European Commission and the European Parliament to EIOPA's decision will be decisive in bringing forward the implementation of this change.

Contact

For further information with respect to this subject, please contact Igotz Aubin.

Igotz Aubin
Director | Risk Advisory* / Financial & Actuarial Risk Advisory
* A Department of Deloitte Bedrijfsrevisoren / Reviseurs d'Entreprises BV o.v.v.e. CVBA
iaubin@deloitte.com |
www.deloitte.be