Press Release

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EIOPA PUBLISHES THE FIRST REPORT ON LONG-TERM GUARANTEES MEASURES AND MEASURES ON EQUITY RISK

- *For the first time the overall impact of the Long-Term-Guarantees measures and the measures on equity risk, contained in Solvency II, on the financial position of European insurers is captured*
- *901 insurance and reinsurance undertakings in 24 countries with a European market share of 69% are using at least one of the measures with the volatility adjustment being the most used one*
- *The results confirm a significant impact on the own funds and capital requirements of insurers*

Frankfurt, 16 December 2016 – Today, the European Insurance and Occupational Pensions Authority (EIOPA) submitted to the European Parliament, the Council of the European Union and the European Commission, its first annual Report on Long-Term Guarantees Measures (LTG) and Measures on Equity Risk in particular on their use and impact on the financial position of insurers. A series of similar reports until 2021 is part of the overall review of Solvency II as foreseen in the Solvency II Directive.

With this report EIOPA analyses the impact of the extrapolation of risk-free interest rates, the matching adjustment, the volatility adjustment, the extension of the recovery period in case of non-compliance with the Solvency Capital Requirement, the transitional measure on the risk-free interest rates and the transitional measure on technical provisions. The measures are intended to limit procyclicality and to help

facilitating a smooth transition to the new regulatory framework of Solvency II providing companies with the necessary time to adapt, in particular in a challenging macro-economic environment.

The results of the report show that:

- **901 insurance and reinsurance undertakings** in 24 countries with a European **market share of 69 %** used at least **one of the measures**.
- **852 undertakings** with a European **market share of 61%** used the **volatility adjustment.**
- **154 undertakings** with a European **market share of 24%** applied the **transitional on technical provisions**.
- **38 undertakings** with a European **market share of 16%** used the **matching adjustment.**
- The **transitional on risk free interest rate** was used by **six undertakings** and the **duration-based equity risk sub-module** by **one undertaking**.

The report concludes that the Long-Term Guarantees Measures have a significant impact on the own funds and capital requirements of insurers. Own funds would be lower by 107 billion euro and capital requirements higher by 50 billion euro if these measures were not applied for the insurers that participated in EIOPA's 2016 Insurance Stress Test.

Gabriel Bernardino, Chairman of EIOPA, said*: "For the very first time EIOPA presents the use and impact of long-term guarantees measures and the measures on equity risks on the financial position of European insurers. The results of this stocktaking exercise confirm a significant impact of these measures on the financial position of insurers whilst indicating that the measures work as intended, including on financial stability as demonstrated by EIOPA 2016 Insurance Stress Test."*

The Report can be viewed here: https://goo.gl/5zQi7C

Notes for Editors:

- EIOPA collected information on the impact of the measures such as matching adjustment, volatility adjustment, transitional measure on the risk-free interest rates, transitional measure on technical provisions through EIOPA's 2016 Insurance Stress Test.

- **"Long-term guarantee"** is linked to the type of guarantees offered or to the duration of the insurance contract. Long-term guarantees are included in many different types of products, mainly life insurance products.

- The post-assessment of the Solvency II Directive requires a review of the long-term guarantees measures and the measures on equity risk until 1 January 2021.

- **The long-term guarantees measures** are the extrapolation of risk-free interest rates, the matching adjustment, the volatility adjustment, the extension of the recovery period in case of non-compliance with the Solvency Capital Requirement, the transitional measure on the risk-free interest rates and the transitional measure on technical provisions.

- **The equity risk measures** are the application of a symmetric adjustment mechanism to the equity risk charge and the duration-based equity risk sub-module.

- **Matching adjustment:** Where insurance and reinsurance undertakings hold bonds or other assets with similar cash-flow characteristics to maturity, they are not exposed to the risk of changing spreads on those assets. In order to avoid changes of asset spreads from impacting on the amount of own funds of those undertakings, they are allowed to adjust the relevant risk-free interest rate term structure in line with the spread movements of their assets. (Re)insurance undertakings may therefore apply a matching adjustment to the relevant risk-free interest rate term structure when they value their life insurance or reinsurance obligations, including annuities stemming from non-life insurance.

- **Volatility adjustment:** In order to prevent pro-cyclical investment behaviour, (re)insurance undertakings are allowed to adjust the relevant risk-free interest rate term structure to mitigate the effect of exaggerations of bond spreads (volatility adjustment). The volatility adjustment is based on 65% of the risk-corrected spread between the interest rate that could be earned from a reference portfolio of assets and the risk-free interest rates without any adjustment.

- **Transitional measure on risk-free interest rate:** For a period of 16 years after the start of Solvency II (re)insurance undertakings may apply the transitional measure on the risk-free interest rate. Under the transitional measure undertakings apply a transitional adjustment to the risk-free interest rate for the valuation of insurance and reinsurance obligations. The transitional adjustment is based on the difference between the discount rates of Solvency I and the risk-free interest rates. At the beginning of Solvency II the transitional adjustment is 100% of that difference. Over the transitional period of 16 years the transitional adjustment is linearly reduced to zero. The transitional measure applies only to insurance and reinsurance obligations arising from contracts concluded before the start of Solvency II.

- **Transitional measure on technical provisions:** For a period of 16 years after the start of Solvency II (re)insurance undertakings may apply the transitional measure on technical provisions. Under the transitional measure undertakings apply a transitional deduction to the technical provisions for their insurance and reinsurance obligations. The transitional deduction is based on the difference between the technical provisions under Solvency I and the technical provisions under Solvency II. At the beginning of Solvency II the transitional adjustment is 100% of that difference, i.e. the technical provisions are equal to the technical provisions under Solvency I. Over the transitional period of 16 years the transitional deduction is reduced to zero. The transitional measure applies only to insurance and reinsurance obligations arising from contracts concluded before the start of Solvency II.

- **Duration-based equity risk sub-module:** The standard formula for the SCR includes an equity risk sub-module that captures the risk stemming from changes in the level of equity market prices. The equity risk sub-module is based on risk scenarios that envisage a fall in equity market prices of 39% or 49%, depending on the type of equity.
  Instead of that equity risk sub-module, undertakings can use a duration-based equity risk sub-module that is, with regard to certain equity investments, based on a risk scenario that envisages a fall in equity market prices of 22%. The duration-based equity risk sub-module can only be

applied by life insurance undertakings that provide certain occupational retirement provisions or retirement benefits and meet further requirements, in particular that the average duration of the undertaking's liabilities exceeds an average of 12 years and that the undertaking is able to hold equity investments at least for 12 years.

- **Symmetric adjustment mechanism to the equity risk charge:** In order to mitigate undue potential pro-cyclical effects of the financial system and avoid a situation in which insurance and reinsurance undertakings are unduly forced to raise additional capital or sell their investments as a result of unsustained adverse movements in financial markets, the market risk module of the standard formula for the SCR should include a symmetric adjustment mechanism with respect to changes in the level of equity prices. The symmetric adjustment is expected to be positive (i.e. the capital requirement is higher) when markets have risen recently, and negative (i.e. the capital requirement is lower) when equity markets have dropped in the previous months.

- **Extension of the recovery period in case of non-compliance with the Solvency Capital Requirement:** Under Solvency II (re)insurance undertakings are required to hold eligible own funds that cover their Solvency Capital Requirement (SCR).

- The **European Insurance and Occupational Pensions Authority (EIOPA)** was established on 1 January 2011 as a result of the reforms to the structure of supervision of the financial sector in the European Union. EIOPA is part of the European System of Financial Supervision consisting of three European Supervisory Authorities, the National Supervisory Authorities and the European Systemic Risk Board. It is an independent advisory body to the European Commission, the European Parliament and the Council of the European Union. EIOPA's core responsibilities are to support the stability of the financial system, transparency of markets and financial products as well as the protection of insurance policyholders, pension scheme members and beneficiaries.