ISTITUTO PER LA VIGILANZA SULLE ASSICURAZIONI

IVASS

LTGA Italian report

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Executive Summary

The Italian participation (in terms of market share) largely met the target required by the European Commission. With reference to data quality, the LTGA exercise highlighted the huge effort to perform evaluation by participants. Anyway, a large percentage of mistakes in filling in the spreadsheets has to be highlighted due to the complexity of methodologies in the tested measures.

In relation to the outcomes, the exercise put in evidence that for the Italian market the application of Solvency II evaluation principles at 31.12.2011 – without LTGA measures (Scenario 0) – would have led to Solvency positions significantly lower than Solvency I ones. In many cases, it would have been necessary to carry out recapitalization to restore deficit situations in respect of required capital (SCR); life undertakings, belonging to the sample, would have appeared particularly undercapitalized.

It is to be noted that an additional run of the Scenario 0 based on 31.12.2012 data - which IVASS asked Italian companies participating to LTGA to perform - showed a significant improvement of the solvency situation for Italian insurers, due to the enhanced situation of spreads and general market improvements. These results highlights that some kind of smoothening of artificial volatility - as pursued by LTG measures - is absolutely essential, so that it is worthwhile exploring how best to ensure its effectiveness.

IVASS acknowledges that the measures tested are part of a package and hence the conclusions drawn in relation to a specific measure should also take into account the interrelations between different measures. Being aware of this, we would like to highlight our main observations related to the tested measures according to the different scenarios, as follows:

- the **Counter Cyclical Premium** (CCP), also in its maximum version equal to 250 bp, did not prove to be effective to countervail the effects of artificial volatility of spreads for the solvency positions of insurers, mainly for life undertakings. Effectiveness of CCP is in fact strongly affected by the impact on required capital. This is mostly undesirable, since CCP is a measure meant to address stressed situations such as the one happened in Italy at the end of 2011.
  To make the CCP successfully working as anti-cyclical measure in stressed market conditions, it's necessary to eliminate or significantly decrease the capital requirement planned for its application and foresee quick and automatic activation measures (without the need of triggers). IVASS would be in favour of setting up a national adjusting measure, to be used in case of crisis, accompanied by a pillar II measure as an alternative to capital absorption (see page 13);

- the **Matching Adjustment** (MA) was applied by Italian undertakings only in the extended alternative version because requirements for the other versions, classic and extended I, are too strict for Italian products. In general, the MA extended alternative application seems to address artificial volatility (though results appear to be excessively good). Nevertheless it's important to underline that the complexity related to all the versions of the MA evaluation declared by undertakings, that also influence the effectiveness of supervision, would make

the MA not adequate. In addition, since the MA is currently applicable to specific products existing only in very few Member States, it would create strong level playing field issues in the internal market. For all these reasons, we do not believe it is worthwhile keeping the MA in the final LTG package;

- the **Transitional measures** proposed are not useful for the Italian market. In particular, for almost all life undertakings, negative values of own funds emerged given the bias/distortions related to re-calculation of Solvency I technical provisions (see page 24). In the awareness of the need of transitional measures necessary to test smooth transition of technical provisions moving from Solvency I to Solvency II, IVASS supports the necessity of determining a suitable curve;

- with reference to **Extrapolation**, results provided highlighted that Italian technical provisions, characterized by a rather short duration , are poorly affected by the tested measures.

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In the light of the above considerations, IVASS supports the introduction of a currency based permanent adjustment to the risk-free rate interest curve, based on the spreads relative to the two main categories of assets held by insurance undertakings, i.e. government and corporate bonds.

The calculation of such adjustments should follow a formulaic approach, should be defined by EIOPA in such a way to render the assessment of technical provisions predictable, and should be disclosed by EIOPA at least quarterly. The level of the adjustments might even vary depending on the type of insurance contracts to which the curve is applied – e.g. some "buckets" could be defined in order to set different levels of applicability. Moreover, a capital charge associated to such permanent adjustment could be defined possibly in a similar way to the one tested in the QIS5 for illiquidity premium risk.

Such permanent adjustment should be combined with a national adjusting measure to be used in case of crisis (as mentioned above and better described in page 13). It would serve the purpose of removing the consequences of the artificial and temporary spread widening, especially with reference to those products including long term guarantees (especially life with-profit policies).

Without the proposed measures for smoothening artificial volatility, during periods of market turmoil, the solvency position of insurance undertakings would not reflect the actual risks they face.

Moreover, IVASS strongly believes that any Pillar II measures alone (like the extension of the recovery period) would not be effective to address the short-term volatility issue, while Pillar I measures are also strongly needed. In addition, it should be recognised that an excessive use of the extension of the recovery period would have the potential to make the SCR meaningless as a target capital, both for the supervisor and for the market, and the longer the period granted to recover the less meaningful the SCR would be.

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We note that in its report, EIOPA proposes an alternative to the CPP, the Volatility Balancer (VB), a new tool on which we would have some interest should this meet the following conditions:

- be designed with the view of achieving a permanent effective measure at European level,

- encompass the possibility of being widened at the potential inception of a (national) crisis, so that one single measure would be helpful to smoothen volatility over time and to deal with peaks of artificial volatility as well.

It is nevertheless acknowledged that the proposed measure, being a brand new one, has not been widely and sufficiently tested nor its functioning and link with other measures are clear enough to get to meaningful conclusions.

As to the design and calibration of the VB, we note that they are currently in a very preliminary stage and there is a clear need for further work on it and to properly assess and test widely the measure.

While we encourage further developments on the possible functioning and calibration of the Volatility Balancer, we need to underline that IVASS internal analysis on the possible impact of the application of the Volatility Balancer to Italian data leads to results that are significantly different from those highlighted in the impact assessment of the EIOPA report.

More specifically, compared to IVASS internal analysis of Italian data, EIOPA report shows much better results in terms of SCR ratio for the VB both in the form of the "currency level" and in the form of the "national level", i.e. results in the EIOPA report shows a higher degree of effectiveness of the VB in the Italian market than that available from IVASS internal impact assessment.

In any case, the calibration tentatively presented in the EIOPA report clearly shows the lack of effectiveness of the measure *vis a vis* its intended objectives.

IVASS stands ready to contribute to further developments on the possible functioning and calibration of the VB, which we think should be defined also according to the quality of the capital to be included in the own funds adjustment, where stricter calibration requirements should lead to higher quality capital. This further work should be aimed to get meaningful results to the benefit of a successful conclusion of the Omnibus II negotiations.

1. Introduction

This section sets out the framework that has been used by IVASS to analyse the LTGA package and to derive conclusions regarding the Italian market. The report follows the structure of EIOPA one, but paragraphs relevant for the Italian market are filled in.

Impact on policy holder protection

In general, the measures currently included in the LTGA package are not considered to have a major impact on policyholder protection under the perspective of the likelihood of default of insurance undertakings.

This is also due to the fact that all LTGA measures allowing for benefits for the insurance undertakings in the calculation of the technical provisions are justified by technical reasons, reflecting the realistic ability of insurers to fulfil their obligations. Moreover specific criteria for application are foreseen, which will avoid an inappropriate use of such measures.

Anyway, the role of the supervisory activity is important in order to guarantee that the LTGA measures will be applied in an appropriate way, hence ensuring that no risk of default or of insufficient technical provisions could arise in the future.

With respect to the MA, IVASS would like to underline that the use of such measure could have potential negative effects on the availability of diversified insurance products in the market: the existence of a MA, according to the features currently envisaged, could push undertakings to develop and sell new types of products for which they can take advantage of the use for the MA, thus undermining the existence of a diversified product offer in the insurance market, which could no longer meet the real needs of policyholders.

Finally, IVASS would like to highlight possible consequences on policyholder protection related to MA being applicable only to national business, as it is stated in the current Omnibus 2 text (77.c.1.j or 77e.1.j). IVASS is not convinced that this aspect has been caught in the exercise and that – for the same insurer X located in country A and active in country B as well - the protection of policyholders of country B (either under the right of establishment or Freedom to Provide Services regime) would be the same as that provided to policyholders from country A.

Impact on effective and efficient supervision

There are some elements of the LTG package which could potentially impact the effectiveness and the efficiency of supervision, requiring additional efforts by the supervisors compared to the Solvency II regime not including LTGA measures.

In order to enable supervisors to provide a sound supervisory judgement, it will be necessary to set up new supervisory procedures, new data requests to undertakings, definition of new indicators and additional reporting templates, which will enable supervisors to have a full picture of the characteristics of the portfolios to which the LTG measures are applied and to have an insight of the real risks to which undertakings are exposed. Also the setting up of a structured database containing data from undertakings which enables comparison among different reference dates and among different undertakings will be needed.

Above all, the MA will require an approval by the supervisor and also an undertaking-specific application and this will need specific supervisory practices; there could be some difficulties in ensuring an equal treatment of undertakings, homogeneity of the methodologies and practices used by the undertakings and in assessing the real risk exposure of the undertakings.

Hence specific procedures will have to be defined in order to assess the requests from the undertakings and also, after the supervisory approval, to check that the requirements for application still holds true.

The MA will probably be the measure requiring more efforts in terms of supervision.

These considerations hold true for all the versions of the MAs.

Implementation effort

For most of the participant undertakings, significant implementation costs are mainly related to the MA calculation, especially because of the vast set of calculations required, and the detailed level of reporting required, that involved different areas and department.

Even if the extent of the impact of LTG package on the implementation effort by undertakings will be strongly dependent from the final version of the legislative text, in relation to the MA, almost all participants stated that the initial impact will be rather heavy.

Such considerations apply similarly to smaller and larger undertakings.

For IVASS, implementation efforts will also be significant, mainly due to the high complexity entailed in the proposed measures (especially the MA, as said above) and therefore also trainings on the new measures proposed will have to be planned for the initial phase. In addition, IVASS believes that concerns on the incremental efforts that the supervision of the MA would require, are equally applicable to its ongoing supervision.

Incentives for good risk management

The high complexity entailed in the measures and especially in the application of MA could undermine quality of risk management. Nevertheless, most of the Italian undertakings considered that LTG measures provide good incentives for an effective risk management, in particular regarding the offer of long term insurance products.

Finally, without CCP, companies would be forced away from their investment strategies during stressed market conditions, causing forced sales and pro-cyclical effects. In general, given their liability maturities, insurers are not very sensitive to short-term market value movements and are able to hold the assets until markets recover having a stabilizing effect on markets.

Impact on financial stability and prevention of systemic risks

The extent of the impact of LTGA package on the investment behaviour of undertakings will be strongly dependent from the final version of the legislative text.

Elements that will likely play a fundamental role in influencing the investment behaviour of undertakings are:

- the criteria for eligibility of assets for the purposes of the MA. In fact, it is possible that the investments in those asset classes that will be excluded from the eligibility criteria could be to some extent discouraged (e.g. floating rate notes, bonds issued by banks with embedded options);
- the requirement of strict ring-fencing for MA could influence asset allocation in the future. In fact, this requirement would reduce the diversification of the portfolio at company level;
- the methodology for calculation and triggering of the CCP, if it will be strictly linked to some specific assets included in the representative portfolio and not to some broader indicators. In fact, this could give wrong incentives to undertakings that could then prefer investments in those specific assets in order to get the maximum benefit from the CCP.

More in general, LTGA measures could help avoiding pro-cyclical effects, provided that necessary amendments to their design are taken into account. There are no specific reasons to conclude that the measures in the LTG package generate procyclical effects or systemic risk.

Impact on insurance and reinsurance undertakings' solvency position

CCP and MA were thought to be the two best candidates to serve the purpose of addressing the issue of artificial volatility of own funds. Nevertheless the practical results of the exercise showed that the impact on undertakings' solvency position was not as effective as though :

- CCP could not be so effective due to the very high capital requirement foreseen. This is mostly undesirable, since CCP is a measure meant to address stressed situations such as the one happened in Italy at the end of 2011. IVASS is of the opinion that the capital requirement related to CCP should be deleted or significantly reduced, whilst the the use of CCP could instead be supported by other Pillar II requirements or corporate law ones (e.g. limitation to dividend payments for the amount of its application) in order to avoid that insurers take undue advantage of a measure meant to be anti-cyclical;
- the MA extended alternative leads to results which are excessively good, and therefore, if the measure is to be kept in the final LTG package, some kind of significant refinement is needed in its calibration and criteria of application.

In relation to transitional measures, as currently designed, they represent a challenging issue for Italian undertakings. In order to get to a good supervisory practice, transitional measures on discount rates should be technically sound and consistently applied across the insurance market. The current approach envisages a "mixed" approach based on an average interest rate between the current discount rates used in SI and the risk free rates to be used in SII, which IVASS could in principle agree on. However, in the Italian market, due to historical reasons related mostly to the national implementation of the Solvency I directives, it is not so easy to identify a Solvency I rate which is comparable with Solvency II one in order to calculate a meaningful average interest: this leads to an artificial valuation under scenario 8 which is not totally comparable neither with SI nor with SII valuations and, most important, leads to meaningless quantitative results.

Impact on competition

With respect to the MA, some disadvantages exist for some countries: other products from other countries (similar in substance to Italian ones, but with formal features more in line with MA current requirements) might instead become more widespread due to favourable application of the MA.

Therefore we think that the definition of eligibility criteria for the application of MA – if it is kept in the final LTG package - should be carefully considered in order to avoid regulation inappropriately influencing business models through the creation of unlevel playing field between similar products just because sold in different countries.

With respect to the CCP, there is the need for a proper triggering and calibration of this tool – able to properly reflect and cope with national situations - in order to avoid the creation of disparity among Member States. This specifically applies for the euro area, where some Members States could have (as experienced recently in Italy) very stressed market situations and others could not be in such crisis situation.

If the CCP is available at currency level only, there could be Member States for which the level of CCP could not be enough to be effective and other Member States that could benefit from the CCP application without really needing it.

Participation/ Coverage

Below the decomposition of the Italian sample by type and size is reported:

Sample mix	**#**
Life	9
Non-Life	0
Composite	8
Reinsurance	0
Captive	0
Total	17

Sample mix	**#**
Large	13
Medium	4
Small	0
Total	17

Following, the market coverage analysis:

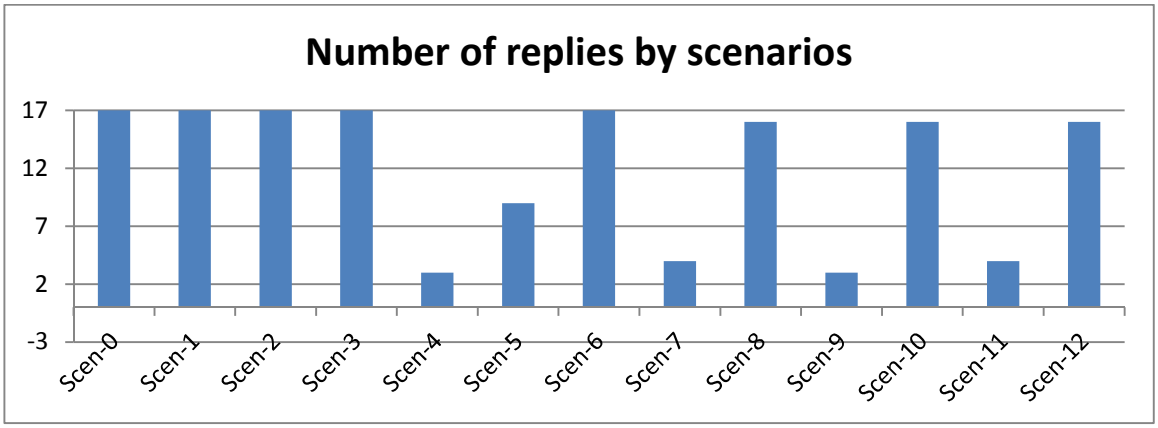
Coverage	
Life - % TP excl linked business of market	**70,7%**
Life - % TP incl linked business of market	**66,0%**
Non life - % GWP of market	**54,7%**

Following, the participant undertakings that provided data according to each Scenario.

The chart below shows that only few Italian participants reported data for scenarios 4,5, 7 and 9.
In particular, the figures reported in these scenarios are almost all unreliable values and, therefore, these can't be considered useful for the analysis.

The values for the following scenarios should be considered reliable:

- Scenario 0 (without LTG measures)
- Scenarios 1, 2 and 3 (different values of the CCP)
- Scenario 6 (MA extended alternative version)
- Scenario 8 (Transitional measure) and
- Scenario 10 and 12 (Historical scenarios, reference date 2009 and 2004)



Moreover, for almost all the sensitivities required, the results can't be considered really representative given the small number of undertakings that provided information.

2. Adapted relevant risk-free interest rate term structure (CCP) – Article 77a

In the table below assumptions used by IVASS for the purposes of the estimation of the national CCP for the YE 2011 are reported:

Reference date: YE 2011

	w(gov)	S(gov)	w (corp)	S(corp)	National CCP
IT	66%	406	26%	235	329,06

Where:

- w(x) represents the percentage of the sovereign and corporate bonds within the assets related to the technical provisions;

- S(x) represents the level of spreads in relation to different asset class.

The reason behind the application of a National CCP for Italian market at 31 December 2011 is that the government bond rates have considerably increased in Italy, giving rise to a very high level of spread between the Italian government bond curve and the European swap curve (which will be used as a basis for the risk-free rate for the calculation of the Technical Provisions). Whilst the long-term average before crisis (from 1999 to 2009) of the spread between the 10 year Italian government bond curve and the 10 year European swap curve was around 0 bps, in 2011 the peaks of this spread reached nearly 600 bps (and in 2012 have then significantly recovered).

The same level of increase in spread was not observed all over the euro area; on the contrary, the rates of some other countries decreased during the last period. This variety of market situation across the euro area would have impacted on the triggering and amount of the CCP, rendering very difficult the task of solving volatility problems in different countries with very different market situations. It is likely that the CCP at currency level would not have been active in those periods where the Italian market was suffering the artificial spread increase, or that, even if active, its amount would have been not enough to compensate the excessive volatility of our market.

For these reasons IVASS thinks that the national CCP, more than the adaptation according to paragraph 2 of Article 77a, would have been the most appropriate measure to address the volatility problem in Italian market at that reference date.

Based on the above assumptions, we can establish that:

- for the composite sample, CCP capital charge is mitigated by non-life side (i.e. the capital requirement for CCP is mitigated by the capital requirements for non life risks through the application of the correlation matrix provided);
- for the life sample, it seems that the CCP - as tested - it is not able to address the artificial volatility due to the related capital charge;
- marginal increase of 79 bps (moving from 250 bps to 329 bps) has a minimal impact on solvency ratio (from 1,38 to 1,40) even if the surplus has a considerable increase.

Aforementioned observations highlight the need of establishing a measure that requires a less capital absorption in order to make such measure effective.

Impact on policy holder protection

Considering the actual characteristics of the LTG measures, with specific reference to CCP there's no major impact on policyholder protection under the perspective of the likelihood of default of insurance undertakings.

Impact on effective and efficient supervision

In general impact on effective and efficient supervision will strongly depend on measures that will be finally included in the future Solvency II legislation.

In particular, with reference to CCP, some specific analysis should be foreseen in order to monitor the status of the market and eventually ask for a triggering at national level. Market indicators, in order to analyze the financial situation and the potential link with activation/deactivation of national, should be foreseen.

During periods when the CCP is triggered, particular attention should be given to the value of technical provisions calculated without the CCP, in order to constantly monitor the difference between the two values (with and without CCP).

Moreover, IVASS support the fact that the usefulness of the CCP for the purposes of the reduction of Own Funds volatility is also linked to its predictability. Even if allowing for some supervisory discretion, we support the idea of having a predictable CCP, in such a way that companies will be able to take it into account when projecting their provisions and capital needs.

The predictability of the CCP should include supervisory actions aimed at understanding how each undertaking takes into account this aspect in its business plans.

Implementation effort

For industry

For almost all participant undertakings, no particular effort with reference to CCP implementation is envisaged.

For NSAs

For the NSA, implementation effort highly depends on final LTGA definition.

CCP will imply some more difficulties connected to supervisory practices given the additional complexity related to calculation of technical provisions that are introduced. In addition, in case of national CCP, the constant monitoring of the market conditions and identification of likely period of market stress will represent a further effort.

Impact on financial stability and prevention of systemic risks

It's important to point out that CCP measure can impact asset allocation, if the methodology for its calculation and triggering will be strictly linked to some specific assets included in the representative portfolio and not to some broader indicators. In fact, this could give wrong incentives to undertakings that could prefer investments in those specific assets in order to get the maximum benefit from the CCP.

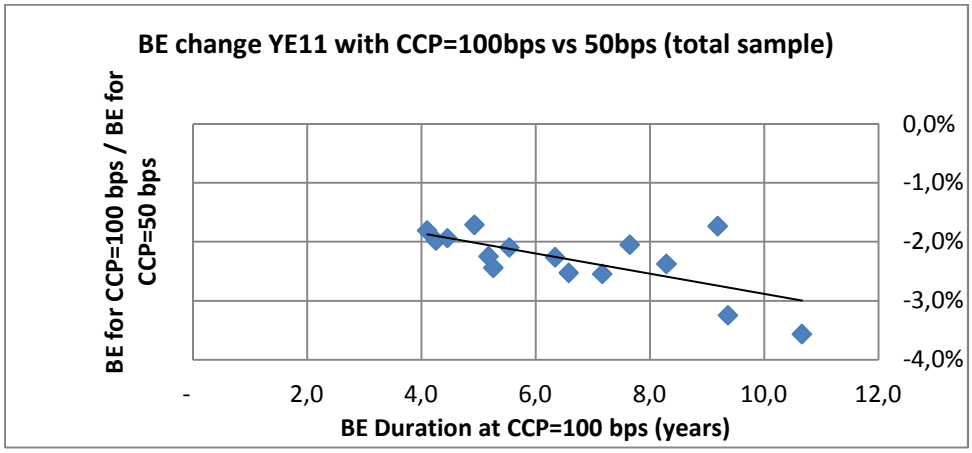
More in general, LTGA measures could help avoiding pro-cyclical effects, provided that necessary amendments to their design are taken into account. There are no specific reasons to generate pro-cyclical effects or systemic risk entailed into those measures: maybe there could be some possible negative effects in case CCP deactivation will be done in a non-smooth manner.

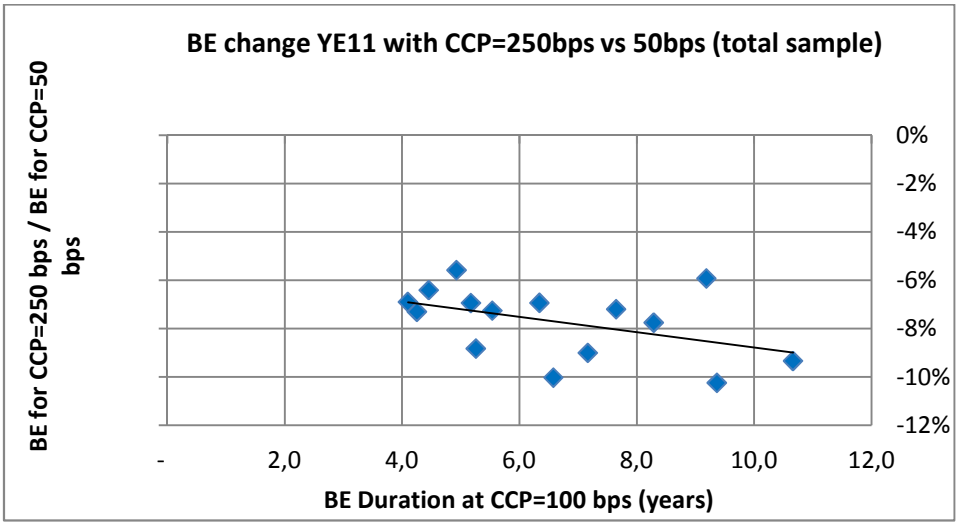
Impact on insurance and reinsurance undertakings' solvency position

All undertakings

This paragraph shows some sensitivities referred to the impact, both absolute and relative, in the solvency position of the Italian sample undertaking. Some large undertakings are excluded from this graphical representation, as they didn't provide information on their liabilities duration.

The following charts show the variation of the Best Estimate (BE) related to the duration of the liabilities.





As a general statement, it's possible to highlight a link between the level of CCP and technical provision duration: for the Italian participants, the decrease of technical provision is higher when duration is longer; Italian results are in line with EU ones.

SII balance sheet volatility

CCP has the purpose of addressing the issue related to artificial volatility of own funds but on the basis of results obtained in LTG exercise the measure did not prove to be effective. In fact, the very high capital requirement accompanying the use CCP substantially countervails its effect on technical provision; in some cases, the impact on the capital requirement proved to be even higher that that on technical provision to which the capital requirement was supposed to be related.

This unexpected result is mostly undesirable, since CCP is a measure meant to address stressed situations such as the one happened in Italy at the end of 2011. For this reason IVASS is of the opinion that the capital requirement related to CCP should be deleted or significantly reduced, whilst the use of CCP could instead be supported by other Pillar II requirements or corporate law

ones (e.g. limitation to dividend payments for the amount of its application) in order to avoid that insurers take undue advantage of a measure meant to be anti-cyclical. IVASS would be in favour of the use of a national adjusting measure, in case of crisis, accompanied by aforementioned Pillar II measures and alternative to capital absorption.

Moreover, it has been noticed that the usefulness of the CCP for the purposes of the reduction of Own Funds volatility, is also linked to its predictability. Even if allowing for some supervisory discretion, IVASS supports the idea of having a predictable CCP, in such a way that companies will be able to take it into account when projecting their provisions and capital needs. In this regard, timely activation of CCP seems to be particularly relevant and IVASS have already expressed concerns on the threshold for the CCP activation because such thresholds have to be able to capture in a timely way the financial turmoil.

In order to avoid that the declaration of a "crisis" or of "exceptional stress" in the market, be it national or not, could even worsen financial stability conditions, IVASS would be in favour of setting clear procedures for the triggering of the measure; those procedures could also take advantage and mirror features/tools available in the banking sector. IVASS stands ready to contribute to the definition of possible procedures in the appropriate fora: below some first suggestions in order to stimulate discussion. For example:

- *triggering/decision for the activation*

  In relation to the decision-making procedure to activate the tool, IVASS would like to suggest two possible options as illustrated below.

  1) A first one, according to which the National Authority triggers the procedure (without the need of a common and automatic trigger) when it verifies the existence of a stressed situation in the national market that induces high volatility, not directly linked to effective changes in the undertaking's risk profile.

  The decision taken by the National Authority is notified to the European Commission, the Council, the European Parliament, ESRB and EIOPA. The European Commission could transform the decision of the National Authority in an implementing act and submit it to the Council which can reject the Commission proposal on the basis of a qualified majority. ESRB and EIOPA could give a non – binding opinion to the Council. The mentioned procedure can last two months at maximum, at the end of which the National Authority can apply such measures.

  It's important to point out that this procedure is set out in accordance with article 443a of CRR that identifies levels of discretion that can be used at national level in case of macro-prudential or systemic risks.

  2) Otherwise, the triggering decision could be envisaged as a purely information procedure started by the National authority that would lead to the triggering of a subsequent control procedure involving the European Institutions. In this case, the information procedure would be automatically triggered on the basis of an adjustment level, defined at EU level but taking into account national specificities, using the aforementioned procedure in case of higher level of adjustment (for potentially higher connection with European macro-prudential stability).

We would like to point out that the more the European Institutions would be involved ex-ante in the decision-making process (as per option 1), the lesser the need for an automatic trigger based on a EU formula, which may be more difficult to agree upon.

IVASS would welcome exploring additional options on the decision-making procedure.

- *adjustment evaluation*

  It has to be performed on the basis of a European formula- defined by EIOPA- that would be able to take into account national specificities and that would be predictable.

- *Pillar II measure*

A capital reserve, not distributable and linked to the "crisis measure", should be identified. The amount of this reserve should be evaluated on the basis of "notional" risk on assets involved or, as it happens for the actual capital requirement on CCP, with reference to the amount of changes of technical provisions.

This measure would be activated directly together with the use of (national) adjustment by the company; thenthe company evaluates "notional" amount of this risk on the basis of criteria established by supervisor and/or at European level.

The National Authority would then submit adequacy of this reserve to a its Supervisory Review Process.

Also the amount of such reserve would be disclosed.

Impact on competition

IVASS wishes to point out the need for a proper triggering and calibration of CCP – able to properly reflect and cope with national situations - in order to avoid the creation of disparity among Member States. This specifically applies for the euro area, where some Members States could have (as experienced recently in Italy) very stressed market situations and others could not be in such crisis situation. If the CCP is triggered at currency level, there will be Member States for which the level of CCP could not be enough to give useful benefits and other Member States that could benefit from the CCP application without really needing it.

Main technical findings on the individual measure (CCP)

The application of the CCP should not imply specific consequences on the offer of insurance products, because this measure will be applicable widely to all insurance products, without distinctions based on the characteristics of the contracts.

On the contrary, the non-applicability of an effective CCP would entail the lack of sufficient measures to address artificial volatility. This could impact some long term contracts, which could be displaced from the market if sufficient measures to protect from artificial volatility will not be implemented.

The results of the exercise are not in line with the expected purposes of CCP due to the high level of capital requirement for the CCP (the SCR shock of 100%) which significantly countervails the effect of CCP on the technical provision and in some cases, with even higher amounts; this holds true especially for Life companies characterized by low level of spread risk charge (i.e. lack of

diversification effects within the market risk). This is mostly undesirable, since CCP is a measure meant to address stressed situations such as that happened in Italy at the end of 2011.

The deletion of such a capital requirement or at least a significant reduction in its calibration of the CCP shock could be investigated in order to completely address stressed situations. The use of CCP should instead be supported by other Pillar II requirements or corporate law ones (e.g. limitation to dividend payments for the amount of its application) in order to avoid that insurers take undue advantage of a measure meant to be anti-cyclical.

Furthermore the CCP has been thought to address specifically the issue of the artificial volatility arising in situation of exceptional stress of the market, and therefore it is to be seen as a measure working only in some specific and extraordinary cases. The CCP calculated at currency level could not always work in practice (i.e. in cases where the crisis situation is not equally widespread among euro area, but is mainly perceptible in one or more specific countries) and hence could not serve the purpose of reducing artificial volatility. Therefore the national CCP is the most useful instrument to deal with artificial volatility arising from crisis situations affecting one specific country.

From the supervisor's point of view, the application of the CCP could imply some changes in the supervisory review practices, especially mirrored to monitor possible (adverse) changes in the amount of the technical provision from one year to another. In fact the creation of a market indicators set would be necessary in order to analyze the financial situation and the potential link with the activation/deactivation of the currency/national CCP.

Finally when applying CCP, some unexpected impact on SCR has occurred from some submissions. This mainly relates to "side effects" deriving from the increase of the capital requirement for interest rate risk and lapse risk (but also other risk modules might be affected in the current data).

These secondary effects could be investigated in order to have a complete picture.

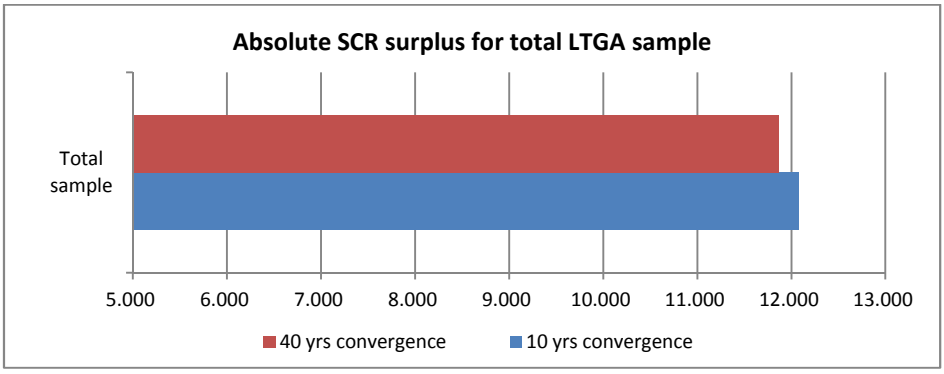
3. Extrapolation – Article 77b

Main technical findings on the individual measure (Extrapolation)

Regarding the methods of extrapolation of the yield curve, the results show that the technical provisions of the Italian participants - characterized by a duration not particularly high - are poorly influenced by the various hypotheses tested.

Moreover, IVASS found out that the impact of extrapolation doesn't depend on size, in fact results don't differ for life and composite undertakings. Also the size is not relevant for final conclusion on extrapolation.

The following chart shows the absolute SCR surplus (in Euro Billions) for the total sample. The two different bars underline that impact of the speed of convergence is negligible for the Italian market (around 1,5%).



4. "Classical" MA – Article 77c

Main technical findings

The "classic" MA was not applied by any of the Italian undertakings in the LTGA sample, neither in its "Standard" nor in its "Alternative" version.

The reason is that the strict criteria foreseen do not render Italian portfolios eligible for this version of the MA. In particular, the requirement which excludes contracts with policyholder options from the application of the Classic MA is very restrictive and prevents the application of such version of MA to a significant portion of Italian contracts.

Consequently, the percentage of technical provision eligible for the Classical MA is close to 0%, and the impact on SCR and MCR ratio are approximately zero as well.

5. "Extended" MA – Article 77e

Implementation effort (with insights on internal model users if possible)

For industry

Almost all undertakings indentified in the MA (in all its versions) the most time consuming measure and the one requiring most efforts. .

Deeper in detail, the elements of the proposed LTG package that for the majority of undertakings are expected to be most time and resource consuming in terms of implementation are the following:

- the full run of integrated asset and liability model to quantify the SCR. For Italian traditional life policies, it is highly time consuming both in terms of computing hours and resources dedicated for extracting and explaining the final results. Such burden will be even more onerous if there will be requirement of treating portfolios where the MA is applied as ring-fenced funds;
- the use of a stochastic economic scenario for each sub-portfolios as required by the MA methodology. This aspect is very difficult to apply both in terms of run's time and resources time consuming.

With specific regard to Italian market, most of the impact would depend on final version of MA procedure, in particular concerning ring fenced fund requirements.

These considerations hold true for all the versions of the MAs (MA classic included).

For NSAs

The MA will probably be the measure requiring more efforts in terms of supervision.

There are some elements of the LTG package which indeed will require additional efforts by the supervisors compared to the Solvency II regime not including LTGA measures.

As the MA will require an approval by the supervisor and also an undertaking-specific application this will need specific supervisory practices; if the current procedure was retained, there could be some difficulties in ensuring an equal treatment of undertakings, homogeneity of the methodologies and practices used by the undertakings and in assessing the real risk exposure of the undertakings.

To supervise the use of such measure, and also to provide the supervisory approval which is required, some specific actions will have to be taken.

These considerations hold true for all the versions of the MAs.

Impact on insurance and reinsurance undertakings' solvency position

The LTGA results showed that the application of the MA, as structured and calibrated in the current design, lead to excessively good results, with a significant positive impact on the Solvency position of the Italian undertakings.

Solvency ratio, in fact, increased notably from the scenario 0 (where no CCP is applied) to scenario 6 (where the Extended Alternative MA was applied). In the light of such results, if the measure is to be kept in the final package, it should be redesigned by revisiting its calibration and criteria for its application in order to avoid results which are not prudent or reliable enough.

The MA is in principle a valid and important measures to reduce fluctuations in own funds in relation to the long term business. In fact, together with the CPP and with an appropriate re-design or recalibration, it would be able to ensure that, especially during periods of high volatility in the markets, the calculation of the Own funds is not highly influenced by market trends that would artificially distort the solvency position of the undertaking.

The benefits produced by this measure could potentially be relevant, but it will highly depend on the version which will be finally included in the legal text, as per scope of application, criteria of application and calibration.

It is to be noted that the application of MA in the LTG exercise was done under the assumption – set out in EIOPA Technical Specification and not so clear in the Omnibus II text - that the use of the MA identifies the portfolio in which the MA is being applied as a Ring Fenced Fund (RFF). Under this assumption, the restrictions imposed to the RFF may largely countervail the impact of MA and its effectiveness, so that the application of the MA may be detrimental even for the eligible portfolios; it would also imply a substantial change in the management and nature of the products/business model.

So, for the purpose of this exercise the assumption was not applied by all Italian participants, i.e. some simplifications were applied and participants communicated an estimate of their impact: an approach based on RFF imposed by the application of MA would have caused a loss of diversification benefit in average equal to 10% of the total SCR.

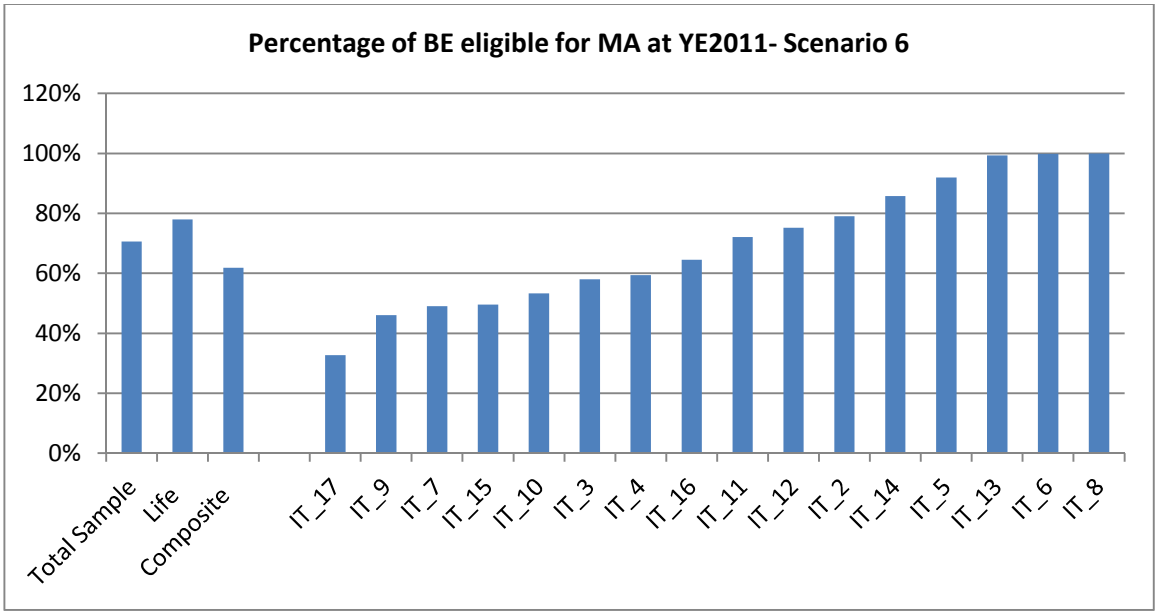
All undertakings

The chart below shows that in scenario 6 the percentage of Best Estimate (BE) eligible for the application of the Extended Alternative MA is, on average in the total sample, equal to 70%.

For two undertakings the totality of the BE would qualify for the application of such measure, whilst for 4 firms, the amount of BE eligible is lower than the 50% of the total BE.

The application of the Classic MA was zero for every undertaking (consistently with what said in the previous chapter on the Classic MA).

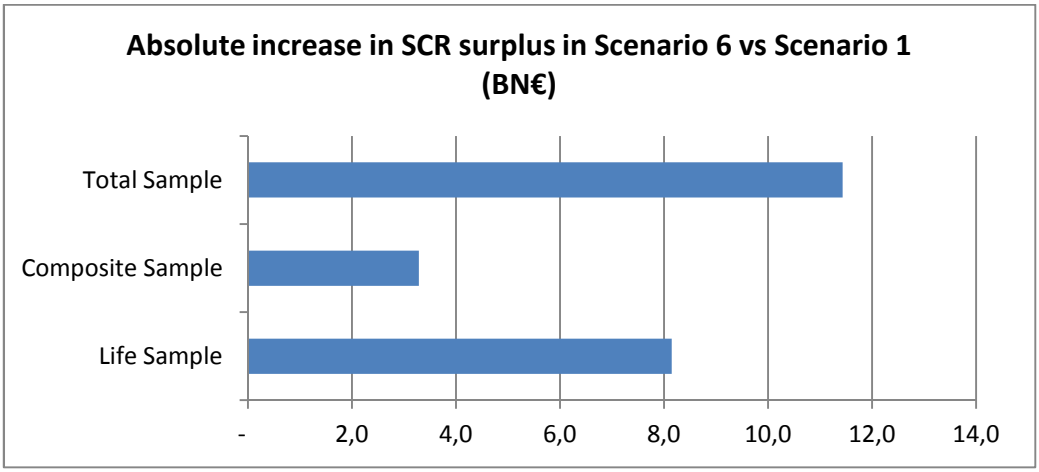
One (life) undertaking in the sample was not reported in the table because it run the scenario without applying the MA, independently from the eligibility of the best estimate.



With respect to scenario 7, only one undertaking applied the Extended Standard II MA, and the percentage of BE eligible for the application of such measure was 10%. Therefore, given that the Classical Extended Standard MA is not relevant for the Italian market, all the table and graphics below will include only data regarding the Extended Alternative MA.

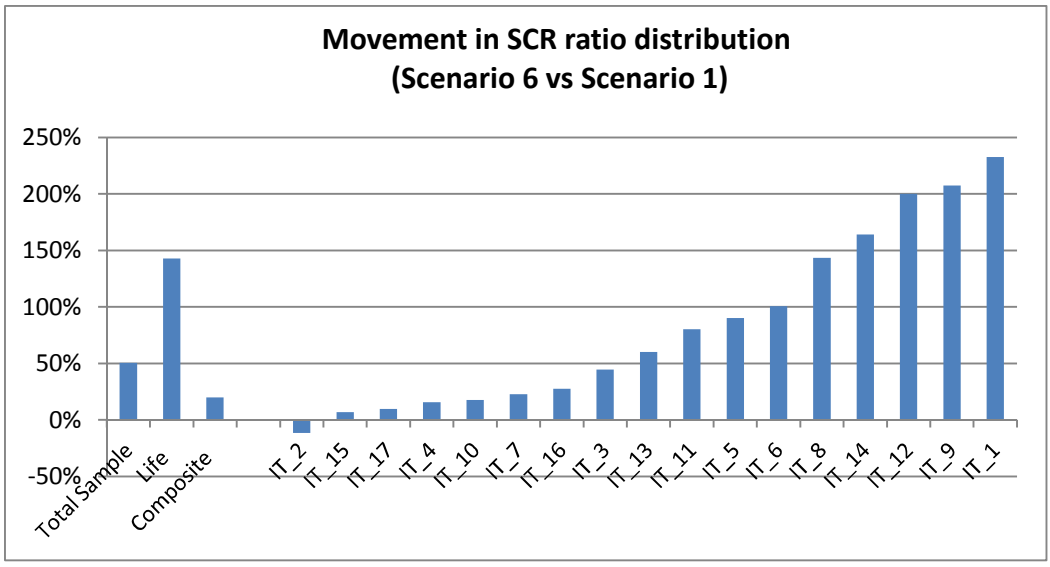
The following table shows the absolute impact on SCR surplus of the Extended Alternative MA, calculated as the difference between the SCR surplus in scenario 6 and the SCR surplus in scenario 1.

In the light of such results, it could be suggested to re-design this measure, softening the criteria for its application but restricting the application ratio in order to avoid results which are not prudent or reliable enough.



The impact on SCR is higher for Life undertakings, where the application of the MA is broader.

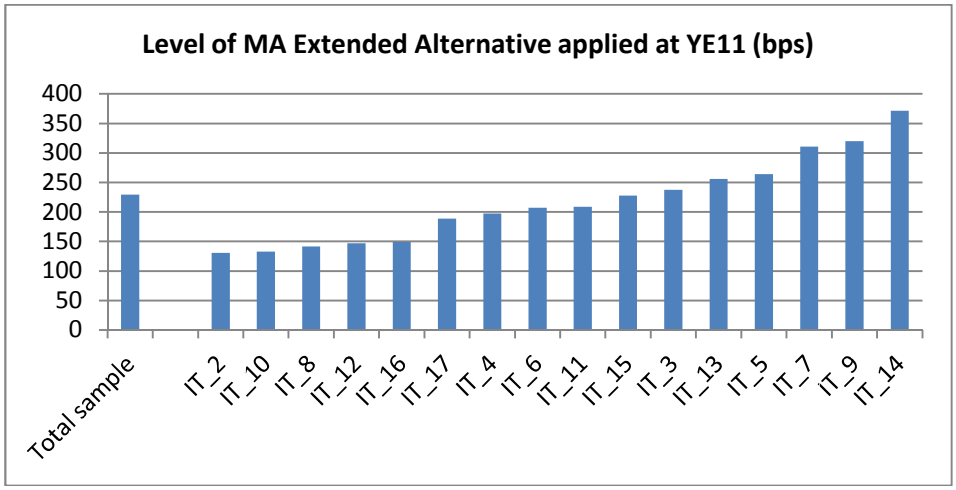
The following table show the impact on the SCR ratio by undertaking, and also for the total, life and composite sample. Such impact is calculated as the difference between the SCR ratio reported in scenario 6 and the same ratio reported for scenario 1, where no MA is applied.



The table shows that the impact is significantly higher for Life undertaking than for Composite undertakings.

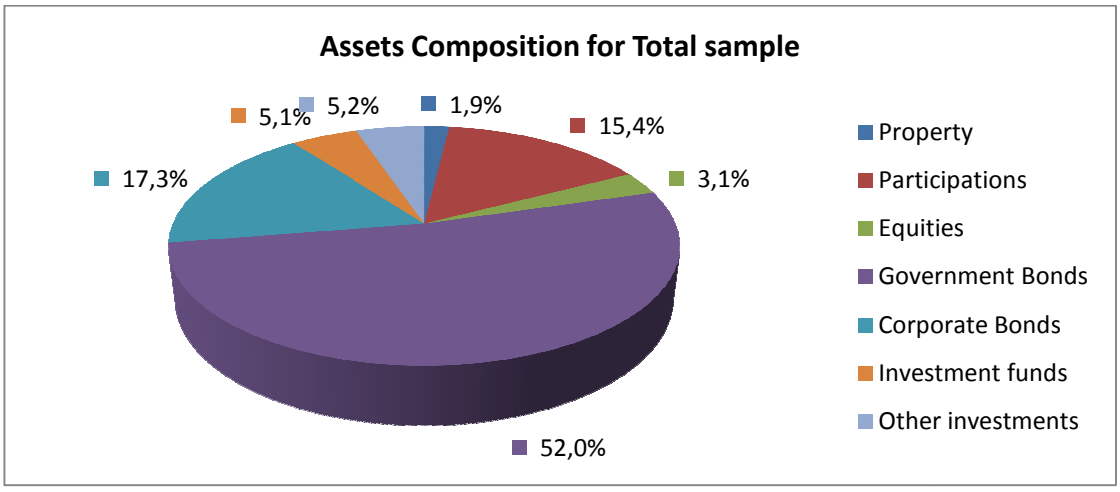
A. Credit quality of eligible assets

The following graph represents the level of MA applied at YE 2011, that is in average equal to 230 bps.

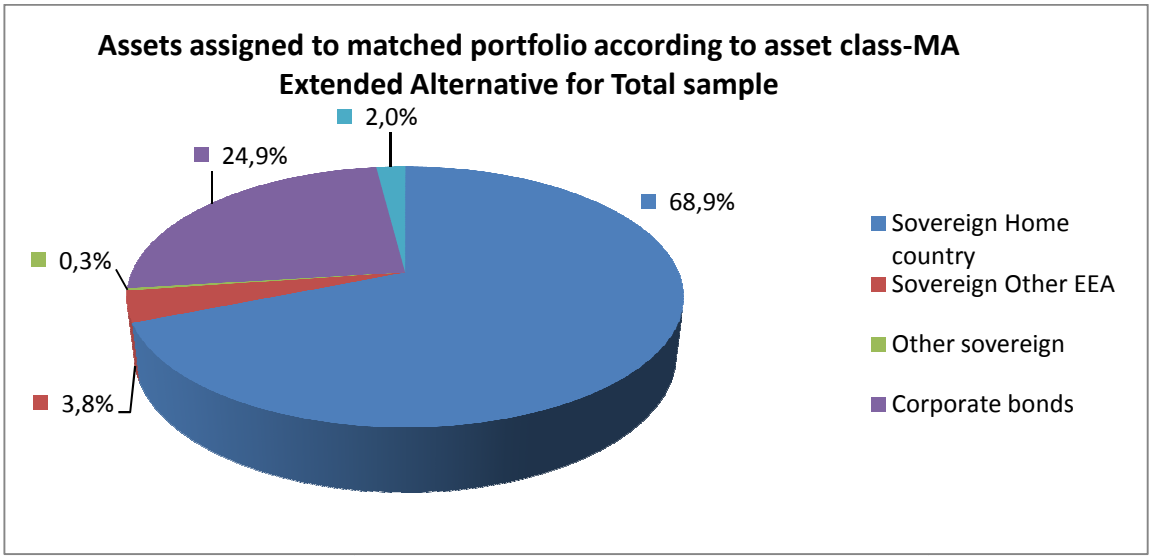


B. Types of assets including fixity of cash flows

The chart below shows composition of Investment of the undertakings. It's clear that Government bonds, on average, represent the major part of undertakings asset composition.



With reference to assets assigned to matched portfolio according to asset class, it's possible to observe a predominance of Sovereign Home country (68,9%), followed by corporate bonds (24,9%).



Finally, with reference to Sovereign assets class, the table below shows the breakdown of bonds according to credit quality step at YE 2011.

Deeper in detail, more than 94% of the total sovereign bonds, in the assigned portfolio to matchthe MA extended Alternative, are classified in CQ 2 (94,2%).

Sovereign bonds

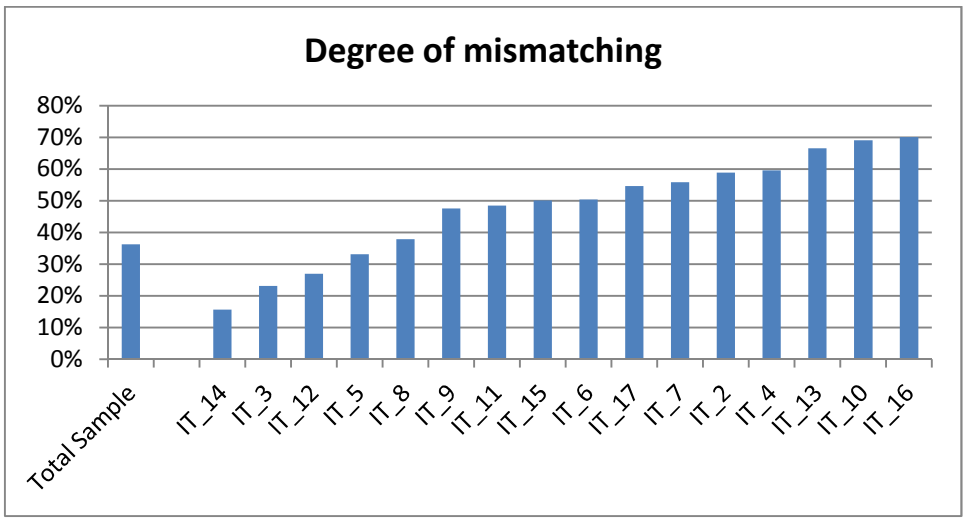
Breakdown by credit quality step at end 2011						
0	**1**	**2**	**3**	**4**	**5 or 6**	**Other/not relevant**
2,6%	1,2%	94,2%	1,6%	0,1%	0,2%	0,1%

C. Matching criteria

For the extended MA, a strict cash flow matching only applies for the Standard versions (over 85% of the cash flows needed to be matched[1]).

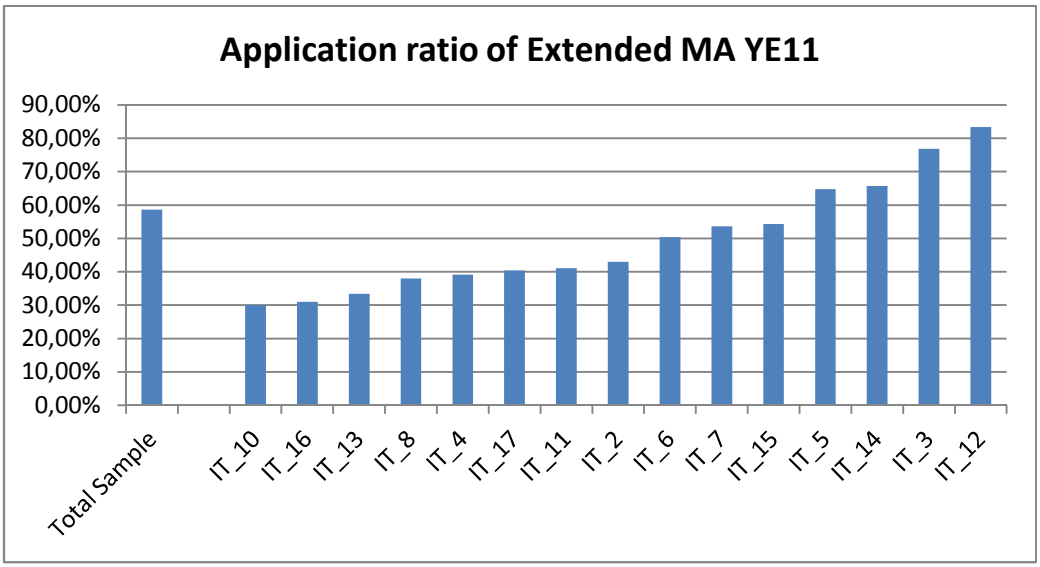
The chart below show that for almost all Italian participants the threshold foreseen for the MA extended Standard I & II is not met, thus they applied only the MA extended alternative version (just one firm was able to apply the Extended I version for a small part of its portfolio).

[1] The Technical Specifications introduced, for the purpose of the LTGA, the threshold of 15% as limit of the mismatch between asset and liability cash flows.



D. Application ratio

The following chart shows that on average the application ratio for the entire sample is around 60%. Anyway it's possible to notice the high variability of the results and that the larger undertakings are characterized by a higher level of application ratio.



With reference to sensitivity 6.i), only two companies provided data requested. One affirmed that the impact is medium on technical provisions, Own funds and SCR; the other one provided an impact on SCR equal to 25,1%.

As a general remark, with reference to all sensitivities, it can be affirmed that results provided don't affect neither type nor size of companies.

SII balance sheet volatility

In the case of the MA extended alternative, the application of this measure actually immunizes the portfolios from artificial volatility

The benefits produced by this measure could potentially be relevant, maybe too much, but they will highly depend on the version which will be finally included in the legal text: if the criteria will be too strict and will imply a ring-fencing of the portfolios, then the MA application will be limited and no benefit in volatility reduction will be in place.

Impact on competition

It is likely that products benefitting from MA will in general be favoured with respect to other long-term products that will not be able to apply such measures, for formal and not substantial reasons. It is therefore essential that, if the MA is kept in the final LTG package, criteria and scope for its application are carefully considered in order to avoid unlevel playing field among different markets/products and to avoid undue influence of regulatory measure on business models.

Main technical findings on the individual measure ("Extended" MA)

The only version of the MA that is suitable for the Italian market is the "Extended alternative" one. Also the "Extended standard" version was not applicable due to the extremely restrictive requirement for the cash-flows matching (shortfall value below 15% of the BE).

As per the alternative MA, tested under scenario 6, IVASS thinks that it leads to results which are excessively good so that – if the measure is kept in the final LTG package - some kind of refinement is needed in its calibration/application as well as for criteria and scope of application.

Since the application of MA entails a number of significant shortcomings (such as the high level of complexity, both in terms of calculations and in terms of supervision; the level-playing field issue) IVASS believe that it is not worth it to keep this measure in the final LTG package.

In general, IVASS thinks that MA is the measure that requires the most important effort in terms of supervision.

6. Transitional measure – Article 308b

Impact on effective and efficient supervision

Transitional measures, as currently designed, represent a challenging issue for Italian undertakings. In order to have a good supervisory practice, transitional measures should be technically sound and consistently applied across the insurance market. The current approach envisages a "mixed" approach based on an average interest rate between the current discount rates used in SI and the risk free rates to be used in SII, methodology that in principle could be shared. However, in the Italian market due to historical reasons related mostly the national implementation of the Solvency I directives, it is not so easy to identify a Solvency I rate which is comparable with the Solvency II one, in order to calculate a meaningful average interest: this leads to an artificial valuation under scenario 8 which is not totally comparable neither with SI nor with SII valuations and, most important, leads to meaningless quantitative results.

As per the quantitative results of this exercise, IVASS asked Italian undertakings to submit an additional simplified scenario based on the maximum guaranteed rate ("Tasso Massimo Garantibile" TMG) that is fixed and published by IVASS monthly. More in general, for the purpose of setting an

appropriate transitional measure in Omnibus II text, IVASS tend to favor the current "mixed" approach, but with a possibility for national supervisors to fix Solvency I rate – in order to move to Solvency II in an orderly way and respectfully of the current Solvency I valuation of technical provisions.

From the spreadsheet provided so far by participants, it is possible to draw that the scenario where TMG is applied, should be feasible for the transitional purposes.

In case of application of transitional measures, some changes in the supervisory review practices have to be envisaged, especially in order to monitor possible (adverse) changes in the amount of the technical provision from one year to another.

Implementation effort

For industry

Given that transitional measures as tested in LTGA are not workable for the Italian market, no implementation effort envisaged by industry.

For NSAs

With reference to those undertakings applying the transitional measures on discount rate, probably the main objective from the supervisory point of view is to monitor the change of technical provisions due to the change of the rates at the end of each of the first 7 years.

In fact, the interest rate curve used to discount liabilities will change for two causes: the change of the mix between Solvency II and current rates and the change of the Solvency II interest rate curve. This could lead to possible cliff that could occur at the end of each year and could then have sensible impacts on the amount of the technical provision.

For this reason IVASS thinks that requiring undertakings to implement sensitivities on the Technical Provision to the change of the interest rate curve could be a good instrument to monitor the range of possible variations of the technical provisions. This could be then used to implement possible supervisory action aimed at avoiding these cliffs and smoothing the variation of technical provisions during the first 7 years from the entry into force of Solvency II.

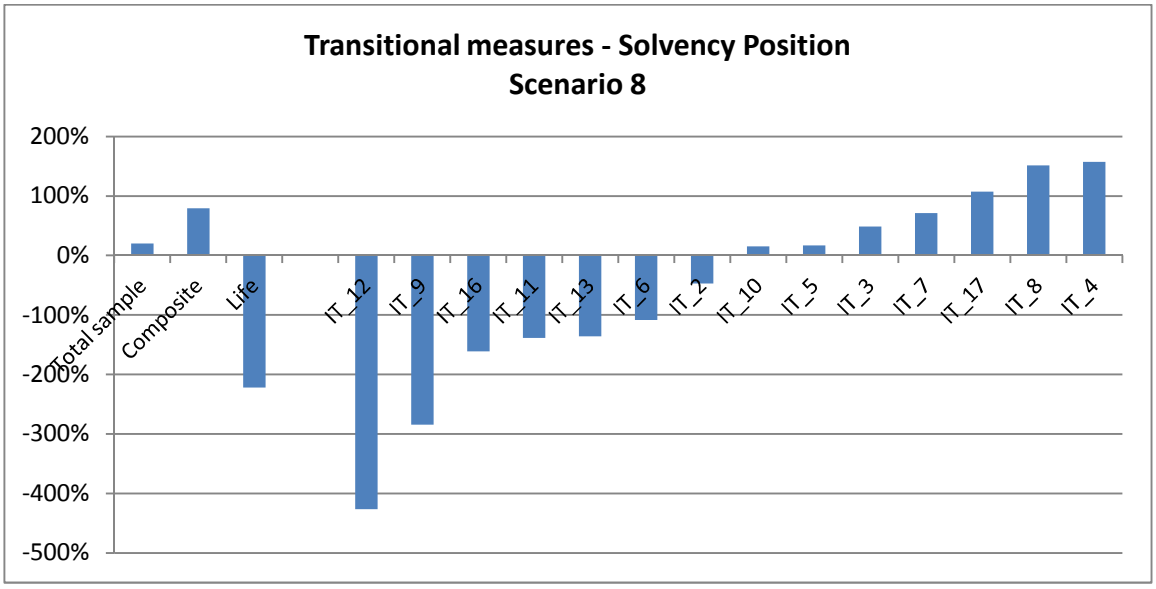
All undertakings

As stated above, transitional measures are unworkable for Italian market so any graphical representation, linked to practical results, is not meaningful.

For almost all companies, the requirement to split out the cash flows of the paid-in part of the contract is not feasible and therefore scenario 9 was implemented by none of the undertakings. Moreover, applying different interest rate term structures within the same contract is not only an almost impossible implementation requirement, but it also lacks an economic rationale.

Results referring to SCR and MCR are unreasonable.

The chart below shows the non workability of the transitional measures for life Italian market. In particular, the chart below underlines that the life undertakings are characterized by a solvency ratio lower than - 200%. Almost all the undertakings with a solvency ratio higher 100% are composites.



Main technical findings on the individual measure (Transitional)

In general, the application of transitional measure as defined in the technical specifications is not methodologically consistent for the Italian market given some peculiarities of the most common life insurance product that do not fit with the proposed approach.

Technical Provisions under Italian local gaap are not calculated with a discounted cash flows approach, and don't include the future profit sharing. It was thus not possible to identify under a Solvency I approach a unique reference rate for discounting.

In addition, where Solvency I rates are close to zero (since the guaranteed rate is zero), the application of the transitional measures leads to unreasonable results.

The main issue is represented by the fact that the application of a Solvency I discount curve gives a worse impact compared to a full and immediate implementation of the SII discount zero curve, since the SI rates are significantly lower.

For the mentioned reasons, IVASS asked Italian undertakings to submit an additional simplified scenario based on the maximum guaranteed rate ("Tasso Massimo Garantibile" TMG) that is fixed and published by IVASS monthly. More in general, for the purpose of setting an appropriate transitional measure in Omnibus II text, IVASS tends to favor the current "mixed" approach, but with a possibility for national supervisors to fix Solvency I rate – in order to move to Solvency II in an orderly way and respectfully of the current Solvency I valuation of technical provisions.

In this context, from the spreadsheet provided so far by participants in relation to IVASS request, it is possible to draw that the scenario where TMG is applied, should be feasible for the Italian market.