EUROPEAN INSURANCE
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Comments on EIOPA Discussion Paper on IBOR transitions	**03 February 2020**

Responding to this paper

EIOPA welcomes comments on the "EIOPA Discussion Paper on IBOR transitions".

Comments are most helpful if they:

- respond to the question stated, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA in the provided Template for Comments, by email to <**aris.dalamangas@eiopa.europa.eu**> by the **30th of April 2020**. Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be considered.

Publication of responses

Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

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[1] Regulation (EC) No 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents (OJ L 145, 31.5.2001, p. 43).

[2] Public Access to Documents (See link: https://eiopa.europa.eu/Pages/SearchResults.aspx?k=filename:Public-Access - (EIOPA-MB-11-051).pdf).

[3] Regulation (EU) 2018/1725 of the European Parliament and of the Council of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC (OJ L 295, 21.11.2018, p. 39).

Reference	
Name of the Stakeholder	Actuarial Association of Europe (AAE)
Type of Stakeholder (please delete in the column to the right the categories which do not apply)	Association
Contact Person	
Email address	
Phone number	
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* Please select: Association, Industry, Ministry, Supervisor, EU Organisation, Other.

Disclosure of comments	
EIOPA will make all comments available on its website, except where respondents specifically request that their comments remain confidential. Please indicate if your comments should be treated as confidential, by deleting the word "Public" in the column to the right and leaving only the word "Confidential".	**Public**

Chapter II		
#	**Question**	**Answer**
	Preliminary remarks	Our comments relate mainly to the EUR denominated swap market. We think it important to note at outset that: (a) For the 6m EURIBOR swap curve, there is a need to differentiate between the reference rate that determines the floating leg payments that are exchanged on payment dates and the discount rate applicable to any collateral transferred during the lifetime of the swap (and hence used to calculate present values for the different legs of the swap). (b) Simplifying a little, whenever a 6m EURIBOR swap is collateralised with cash / cash equivalents, market practice nowadays involves collateral discount factors that are EONIA based. This is in general the case for cleared swaps and swaps under a CSA (or comparable arrangement) that allows for cash / cash equivalents. (c) Therefore, to fully describe a swap curve one has to give information on the reference rates for the payments as well as the discount factors. For example, on Bloomberg you will find in the description of the 6m swap curve (for the 10 year tenor type EUSW10 INDEX DES) that the floating leg (payments) are based on the 6m EURIBOR (EUR006M INDEX) while the discounting is done with respect to the OIS curve. Please note that LCH and EUREX are planning to change the derivation of discount rates for cash collateralised swaps that they clear from EIONA to €STR around 27 July 2020, see https://www.lch.com/membership/ltd-membership/ltd-member-updates/transition-to-€STR-Discounting-Updated-Timing and https://www.lch.com/membership/ltd-membership/ltd-member-updates/transition-to-€STR-Discounting-Updated-Timing and https://www.eurexgroup.com/group-

		en/newsroom/circulars/clearing-circular-1942440. It seems reasonable to expect CSA and comparable arrangements that allow for cash / cash equivalents as collateral will also be renegotiated to use €STR for the derivation of discount factors. (d) Different discount factors therefore lead to different overall yield curves, different forward swap rates and different derived swaption pricing. We recommend that the distinction between the reference rate and the discount rate be highlighted more explicitly in the final consultation paper, to ensure that everyone has the same understanding of how any proposed transition might work.
Q.1.	Do you agree with the overall approach regarding the Credit Risk Adjustment?	Yes. Please also see our answer to Q4.
Q.2.	Do you consider OIS based swaps to have a non-negligible* credit risk? If yes, what is your recommendation for calculating this risk? (*Negligible is defined as below one basis point.)	Normally no. However, in extremely stressed times, even investments expressing minimal credit risk (e.g. secured overnight lending, use of highly creditworthy government debt repo etc.) might still be ascribed some noticeable credit risk by the market, e.g. due to worries that society-wide legal and other financial infrastructural underpins on which an ultra-low credit risk status depends may become impaired. In such times, differences between alternative ways of measuring 'risk-free' may also become more evident due to market imperfections, dislocations, timing mismatches or other frictions. To avoid needing to explore this sort of issue further, we suggest replacing the footnote definition of 'negligible' (there defined as 'below one basis point') with one that is more aligned with how different jurisdictions are justifying that their new 'near' risk-free rates are sufficiently risk-free to be suitable replacements for IBOR.

Q.3.	Which is your preferred option for treatment of the credit risk adjustment?	Option 2.
Q.4.	Is there any alternative option you believe EIOPA would need to consider regarding the treatment of the CRA?	As explained in our preliminary remarks, EIOPA should consider adapting their approach and the options being pursued to cover how EURIBOR swaps are collateralised, as this influences the yield curve derived from market observed prices for such swaps. EIOPA could also explore altering the corridor applied to the relevant IBOR, but we think this would only be worth exploring further for currencies (if any) where the timeline for transition to OIS is expected to be very lengthy or where no current plans exist for such a transition (and hence where EIOPA IBOR-based RFRs might last indefinitely).

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Chapter III		
#	**Question**	**Answer**
Q.5.	Do you agree with the overall approach regarding the blending of the new and old RFR term structure?	We agree with the summary provided on Table 1. However, for EUR, the approach depends on the assumption that in due course the OIS swap (€STR) will gradually gain liquidity and replace the 6m EURIBOR, which would be reflected in the DLT assessment. To the best of our knowledge we have no information for the EUR zone on whether the transition from (collateralized) EURIBOR swaps to €STR swaps is strongly supported, making it unclear whether and when the transition for EUR will take place.
Q.6.	Do you agree with the proposal of EIOPA implementing option 2?	Of the three proposed approaches, we think that a blended approach (Option 2 or 3) is probably preferable to a sudden volume-specific total switch (Option 1), because an unpredictable sudden switch from one curve to another could cause instability, particularly if the spread between them at the time is material. However: (a) We think that there may be other possible options that could provide a more stable transition process with lower complexity, as long as it is reasonable to assume that the transition will take place at some stage in the foreseeable future. See our answer to Q7. (b) Out of the three proposed approaches, we think that Option 3 (tenor bucket volume approach) is likely to be preferable to Option 2 (total volume based approach), as long as there is sufficient transparency from EIOPA on how at any given point in time the EIOPA RFR is and will be derived from the different IBOR and OIS based components. The financial impact on insurers may be dominated by changes at the longer end of the yield curve, i.e.

		at tenors near the last liquid point (LLP) (or beyond it, depending on how RFR extrapolation beyond the LLP might operate post implementation of any changes following on from the Solvency II 2020 Review). This is because insurers particularly sensitive to interest rate risk tend to have long-term liabilities. Volumes seem to be shifting from IBOR to OIS much more rapidly at the shorter end of the yield curve. In some jurisdictions the large majority of interest rate swap volume is for short or medium term tenors. Therefore there is a material risk under Option 2 that the longer end of the EIOPA RFR curve could end up being shifted to OIS despite only a small proportion of the volume at that end of the yield curve having shifted to OIS.
Q.7.	Do you think there can be another alternative EIOPA needs to consider regarding the blending of the curves? Please provide an explanation.	We suggest that EIOPA also examines an option along the lines of: (a) Transition from existing RFR to OIS based RFR on a fixed transition date (b) The transition to be subject a transition period akin to those used for the LTG transitional measures (e.g. transition on risk-free interest rates, transition on technical provisions) Such an approach would not be dependent on market developments, which would provide greater stability and make it planning easier. It would also use a more easily observable curve instead of an artificial blended curve with changing weights, thus reducing complexity. However, it has the downside that it would lead to an inappropriate RFR transition if the market never practically transitions to OIS swaps. Perhaps such an option could be conditional on some clearer evidence that a shift was underway beforehand, in which case it could perhaps be viewed as a deferred variant of the Option 1 presented in this paper, with the deferral involving transitional arrangements akin to those already used by Solvency II.

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Q.8.	Do you agree with the proposal of EIOPA to set a trigger at 85% of the total volume traded, prior to a complete shift to the new OIS term structure?	Please see our answers to Q5, Q6 and Q7 for alternative ways of deciding on when a complete transition might take place. For Options 2 and 3 presented in this paper, we agree that for practical reasons some trigger may be needed to initiate a complete switch-over. However, for reasons set out in our answer to Q6, we think that consideration should be given to the possibility that volume shifts could be much smaller at the longer end of the yield curve than at the shorter end, with any such trigger adapted accordingly.