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Public Consultation on IBOR transitions

Fields marked with * are mandatory.

Responding to the paper

EIOPA welcomes comments on the Consultation 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 using the EU Survey tool **by Friday, 23 July 2021 23:59 CET** by responding to the questions below.

Contributions not provided using the EU Survey tool or submitted after the deadline will not be processed.

Publication of responses

Your responses will be published on the EIOPA website unless: you request to treat them confidential, or they are unlawful, or they would infringe the rights of any third-party. Please, indicate clearly and prominently in your submission any part you do not wish to be publicly disclosed. EIOPA may also publish a summary of the survey input received on its website.

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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] Decision (EIOPA-MB-11/051) of the Management Board concerning public access to documents - Public Access to Documents
[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)

About the respondent

* Please indicate the desired disclosure level of the responses you are submitting.
- (●) Public
- ( ) Confidential

* Stakeholder name

Actuarial Association of Europe (AAE)

* Type of Stakeholder
- (●) Association
- ( ) Industry
- ( ) Ministry
- ( ) Supervisor
- ( ) EU Organisation
- ( ) Other

* Contact person (name and surname)

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Questions to Stakeholders

* 1. Do you agree with the overall approach of the immediate switch subject to the two preconditions?

- [x] Yes
- [ ] No

* Please add an explanation

Yes, we do agree with the overall approach of the immediate switch subject to the two preconditions.
We welcome the approach for its simplicity. We assume the liquidity and proximity condition appropriate to reduce the risk of instability and breaks in the RFR term structure.

Switching from one curve to another one can create market distortions. It is difficult to anticipate the resulting impact without the results of the impact study. An impact on the reinsurance market should be considered (see also our answer to Q6).

For EURO and USD, there is no date of transition. The publication of both methodologies for the curve construction could help insurers for the transition.
On June 8, CFTC (Commodity Futures Transition Commission) recommended that the inter-dealer market start to implement "SOFR First" (SOFR= Secured Overnight Financing Rate) trading in interest derivatives on July 26, 2021 and to turn off USD LIBOR swaps screens on October 22, 2021.
This action could strongly accelerate transition to SOFR and a transition before the end of the year for USD is possible. If it happens, both preconditions could be reached and could have an impact on insurers' balance sheet already this year.

Insurers should have time to prepare for such a switch. In order to ensure a smooth transition one could think about postponing such a switch to the next year.

* 2. Do you agree with the way the 'liquidity' condition is defined?

- [x] Yes
- [ ] No

* Please add an explanation

Yes, we do agree with the way the ‘liquidity‘ condition is defined.

With regard 2.12: It would be interesting to explore why the CHF and JPY swap volumes are currently so low although IBOR curves are ceasing by the end of 2021. One reason could be that the market is planning to switch essentially overnight (e.g. towards end of December) . In this case, it might not be adequate to focus on the observed liquidity in OIS swaps shortly before the transition date. To the extent that OIS swaps shortly after the transition date were reasonably predictable an adatation of the ”liquidity” criterion could be considered in order to take into account this expected liquidity. Thus one should consider a differentiation between currencies with regard to the threshold level. If the trading volume is increasing on JPY and CHF currencies a level close to 50% could be considered sufficient.

For clarification: According to 2.10, EIOPA is well aware of the fact that under the current circumstances and market standards it can be expected for EUR and the USD (To consider: recent recommendations of CFTC concerning USD see answer to Q1) to take some time (years) until the liquidity condition is met. A necessary prerequisite for a switch should be the compliance with the ‘liquidity’ condition.

* 3. Do you agree with the way the ‘proximity’ condition is defined?

- (•) Yes
- ( ) No

* Please add an explanation

Yes, basically we do agree with the way the ‘proximity‘ condition is defined.

The considered proximity criteria are assessed globally over the whole term structure giving the same weight to the different maturities. However some maturities might be more or less important depending on the bulk of liability CF of EU undertakings.
The proximity concept of the rates could be enriched with a proximity on the liabilities calculated at the risk-free rates. Appropriate ranges could then be defined.
If adequate, an intermediate approach could be the use of the concept of modified duration to assess whether some maturities would require a closer follow up on the proximity criteria.

Further to consider: IBOR curves for GBP, JPY and CHF currencies will disappear. Once a switch on governmental curves for those currencies has incurred, it is unclear how the 'proximity' condition should be considered.

* 4. Do you believe the ‘proximity’ condition has to be met for three consecutive months or a shorter period would be sufficient?

- (•) Yes
- ( ) No

* Please add an explanation

A reasonable balance has to be found on the timing for implementation. The ‘proximity’ condition should be met for a period of three consecutive months. Less than 3 months might be insufficient for undertakings to anticipate the impacts on their liabilities and ALM strategies. A too long deferral of OIS term structures should also be avoided especially if IBOR rates become illiquid. A backstop could be foreseen if the “3 consecutive months proximity” condition leads to undesirable consequences over time.

Insurers should have enough time for switch on the new curve after this condition is met. They should have the opportunity to prepare themselve.
For practicality reasons it might be worthwhile to examine whether a change should take place shortly before the end of the year (balance sheet period) or whether the change should take place e.g. in the first three quarters of the year.

* 5. Do you think there is another condition EIOPA would need to consider for the immediate switch to the new OIS term structures?

- ○ Yes
- ● No

* Please add an explanation

No, we do not think that EIOPA should consider further conditions.

The 'proximity' condition should be met for maturities after the LLP even considering the review of S2.The review of the standard formula and the revision of interest rates should be considered in parallel.
UK FCA published on March 5, 2021 some spread adjustment for fallback that could be applicable at the end of IBOR. Does EIOPA also consider similar adjustments of some rates on RFR? https://assets.bbhub.io/professional/sites/10/IBOR-Fallbacks-LIBOR-Cessation_Announcement_20210305.pdf"

* 6. Do you believe that the foreseen changes in the RFR methodology due to IBOR transitions and the method of switching the underlying instruments (depending on the proximity and liquidity condition) could have an impact on the market rates itself, and if so, with what impact and how might this be mitigated?

- ● Yes
- ○ No

* Please add an explanation

We think there is an impact on trade volumes because insurers would protect themselves with derivative products based on this CDT. This increases liquidity.

Such an impact on market rates and the quantification can hardly be assessed reliably. In general,an increasing demand to receive the fixed leg and pay the floating leg will put some pressure on the rates. If the transition takes place if both preconditions are fulfilled, a gradual switch could in general take place without mayor impacts. However, if insurance companies increased the amount of swaps in a very short time period after the transition the rates could experience some pressure. A fast decreasing liquidity in the IBOR market could affect the value of swaps in place as well. Finally a sudden increase in the spreads between IBOR and OIS (e.g. 6m EURIBOR and €STR) would obviously influence all term structures.

* 7. Do you agree with the overall approach regarding the CRA?

- (●) Yes
- ( ) No

* Please add an explanation

Yes, we do agree with the overall approach regarding the CRA.

* 8. Is there any alternative option you believe EIOPA would need to consider regarding the treatment of the CRA?

- ( ) Yes
- (●) No

* Please add an explanation

No, we do not believe that there is an alternative option EIOPA has to consider regarding the treatment of the CRA as soon as the switch to €STR is realised.

*

9. Would you have a view on how to treat the CRA for those currencies for which the CRA is currently being derived from either the CRA for the EUR or the CRA for the USD?

- ○ Yes
- ◉ No

* Please add an explanation

Currently we do not have a view on how to treat the CRA for those currencies for which the CRA is currently being derived from either the CRA for the EUR or the CRA for the USD. We agree with 3.4. that this can be addressed at a later stage.

* 10. What is your opinion about the proposed changes in the LLPs and the use of government bonds for the JPY and CHF?
Please explain.

A change of LLP based on the data available in the transitory period requires a thorough analysis. This includes a check whether observed changes are permanent and will continue to exist after the transition to OIS. For GBP and US the DLT assessment would focus on the aggregate swaps liquidity (both IBOR and OIS) rather than just the OIS liquidity (on the grounds that volume is likely to migrate from IBOR to OIS once the transition is complete rather than disappearing).

So, if a shift in the LLP to 30 years for GBP or USD is being indicated purely because at the expected time of the switch liquidity at the long end is expected to be depleted in OIS due to continuing activity in IBOR swaps then it may be better to keep the LLP at 50 years throughout rather than change it from 50 to 30 years only to be likely to change it back to 50 years shortly after the transition completed.
The method for CHF is similar to that used for SST. For the JPY, this methodology is less easily justifiable.

* 11. What is your view on the proposed treatment of the LTAS?
Please explain.

In consideration of the arguments in 4.10 - 4.11 concerning data availability and past experience (change of data provider) we support the proposed approach.

Adjusting the spreads over the last 30 years in absence of data would be disproportionate and arbitrary. Though not expected to be material, we note a slightly underestimation of the LTAS which in turn leads to a slightly overestimation of the VA.

Privacy Statement related to Public (online) Consultations

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2. The controller responsible for processing your data is EIOPA's Executive Director.
3. Address and email address of the controller:
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fausto.parente@eiopa.europa.eu

Contact details of EIOPA's Data Protection Officer

4. Westhafenplatz 1, 60327 Frankfurt am Main, Germany
dpo@eiopa.europa.eu

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Contact

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