

Q&As about the publication of the Solvency II relevant risk-free interest rate term structures

What is being published?

The publication consists of Technical Information and Technical Documentation.

Technical Information consists of:

- Risk-free interest rates term structures for 53 countries - 2 sets of term structures per country for the interest rates with and without volatility adjustment;
- Values of the volatility adjustment to the relevant risk free interest rate term structure;
- Values of the fundamental spread to be applied for the calculation of the matching adjustment.

The Technical Documentation consists of the methodology, assumptions and data used to calculate the Technical Information.

Why is EIOPA publishing these Solvency II relevant risk-free interest rate term structures?

Insurance and reinsurance undertakings have to set up technical provisions for their insurance and reinsurance obligations. Under Solvency II those technical provisions will be discounted with risk-free interest rates. The Solvency II Directive requires EIOPA to publish risk-free interest rate term structures for that purpose.

For whom is the Technical Information relevant?

The Technical Information is relevant for insurance and reinsurance undertaking falling under Solvency II and their supervisory authorities.

What is the purpose of the Technical Documentation?

The Technical Documentation specifies the methodology that EIOPA applies to the calculation of the risk-free interest rate term structures in line with Solvency II. By publishing the Technical Documentation EIOPA ensures transparency about the methodology. In particular, by means of the Documentation stakeholders can understand how the term structures will change when the market inputs of the calculation change.

Solvency II starts in 2016. Why does EIOPA publish Technical Information already now?

Insurance and reinsurance undertakings need to prepare for the introduction of Solvency II. The availability of the Technical Information at this stage will facilitate that preparation. Moreover, some approval procedures for Solvency II start already in April 2015, for example for the use of internal models to calculate capital requirements. Knowing how the risk-free interest rate term structures are calculated will help the undertakings in specifying their applications.

What will happen from 2016?

From January 2016 insurance and reinsurance undertakings will have to use the updated term structures for the calculations of the technical provisions under Solvency II.

What will be the impact of calculating technical provisions with the published term structures?

The risk-free interest rate term structures will change over time, depending on market parameters, in particular the level of market interest rates. Therefore, the amount of technical provisions will usually increase when market interest rates decrease and vice versa. This will allow undertakings and supervisors to better assess the risks that changes in market interest rates will pose to insurance and reinsurance undertakings. Better risk management will ultimately be of benefit for consumers.

Have there been any amendments to the risk-free interest rate calculations?

EIOPA began publication of the risk-free interest rate curves in 2015 as a preparatory step ahead of the full implementation of Solvency II in 2016. It is usual that there should be some refinements to the calculations during this preparatory phase: we are using it to analyse and check risk-free interest rate calculations. Moreover, EIOPA is reviewing the risk-free rate methodology during 2015 and would also expect changes to result from this.

For end-April and end-May 2015 technical information, monthly published risk-free interest rate information has benefitted from this further analysis.

What have the changes consisted of?

The first amendment was a minor bug in the coding used to implement the methodology for the probability of default and the cost of downgrade.

The second one relates to differences found in downloading yield data in the historical database mainly for 1 year French government bonds but also for a specific month in 1 year and 2 year government bonds from other countries and some specific country government bond missing data.

This historical database of yields is used to calculate the fundamental spread.

Had these amendments any consequences for the methodological framework?

No. The findings were regarding the implementation of the methodological framework in the coding and the input data.

Therefore, its correction has no impact on the methodological framework.

What was the impact of these amendments?

For the first refinement, the amendment is on the calculation of the probability of default and the cost of downgrade, which in turn have minor consequences for the fundamental spread and hence on (1) the volatility adjustment and on (2) the firm-specific matching adjustment. There is no impact on the basic risk-free curves.

For the second refinement the affected figures would imply a negative fundamental spread. However, the impact on the fundamental spread (and hence on volatility and matching adjustment) is zero. This is because the fundamental spread, as a component of the overall spread, cannot be negative. When negative values arise these are set to zero.

Are previous months' risk-free interest rate calculations going to be re-published?

The previous curves will not be updated in light of: the very small impact of the changes; that the amendments concern the implementation of the technical documentation and input data and not the methodology itself; and that during 2015 the methodology is subject to review which may give rise to further refinements.

Can further refinements be expected?

Additional refinements could be carried out. EIOPA is using this preparatory phase to analyse and check risk-free interest rate calculations. Changes might be expected as a result from this.