	Comments Template on Request for Feedback on Methodological Considerations regarding Illiquid Liabilities	Deadline 7 December 2018 23:55 CET
Name of Company:	**AMICE (Association of Mutual Insurers and Insurance Cooperatives in Europe)**	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Confidential/Public
	Please follow the following instructions for filling in the template: ⇨ Do **not** change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇨ Leave the last column empty. ⇨ Please fill in your comment in the relevant row. If you have no comment on a paragraph or a cell, keep the row empty. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. **Please send the completed template, in Word Format, to CP-18-004@eiopa.europa.eu** **Our IT tool does not allow processing of any other formats.** **The numbering of the reference refers to the questions** in the Request for Feedback on Methodological Considerations regarding Illiquid Liabilities. Please indicate to which question your comment refers.	
Reference	**Comment**	
General Comment	**Background** The long-term business model of (re)insurance undertakings is **founded on** : - The illiquid nature of the liabilities (**according to the definition below, also repeated in our answer to Q1**) - The selection process and the type of management actions applied to investments The illiquid nature of the liabilities will provide time horizons for investments and protect the (re)insurance undertaking against forced sales. The selection process and the type of management actions applied to investments are based on	

economic and financial information and the nature of the liabilities.

The long-term business model is **<u>supported and featured by</u>** :

- risk appetite,
- ALM
- investment policies.

It is important to underline that the above features are key elements of the governance framework and are defined under the assumption that the insurance undertaking is conducting business as a going concern. Investment decisions are based on business plans approaches tested for risks and with real world assumptions as reflected in the liquid market values.

Illiquidity provides access to the “illiquidity premium” offered by financial markets as long as there is enough cash, cash equivalents or exposures which can be readily converted into cash to manage the short end of the liability cash flows taking into account all risks and the management actions associated to them.

<u>Definition of Illiquidity (see answer to Q1)</u>

A clear and complete definition of illiquidity is required and should be based on the following features :

a) The duration
b) The predictability
c) The going concern

It is imperative that duration and predictability be assessed under the assumption that the (re)insurance undertaking is conducting business as a going concern. Hence, in order to fully reflect illiquidity the durations of best estimates in the S2 balance sheet should be extended by an additional factor meant to capture the elements of going concern that are left outside the balance sheet.

Predictability should be properly characterised in a holistic way with proper mutualisation and

	diversification reflecting the level at which ALM is undertaken. Predictability should not be a binary “zero” or “one” approach. **<u>Do not narrow the scope beforehand</u>** Following the definition above (and repeated in answer to Q1) the “request for feedback” of the on-going survey should absolutely not be limited to life insurance business but extended to all (re) insurance undertakings and businesses meeting the features of the definition above. Especially for non-life insurance liabilities, the renewals should be taken into consideration as they are when making investment decisions. Especially also because many cash outflows will be covered by the future premiums received, non-life insurers are able to invest in the longer term . And lastly the long-term objectives and assets are also supported by the significant amounts of own funds.	
Q1	**No, key features characterising the illiquidity of (insurance) liabilities should also include going concern.** To characterise the illiquidity of liabilities the three following features are indispensable : d) The duration e) The predictability f) The going concern (a company with no perspective of new business or renewal would alter materially its ALM) **<u>It is imperative that duration and predictability be assessed under the assumption that the (re)insurance undertaking is conducting business as a going concern</u>**. Hence, in order to fully reflect illiquidity the durations of best estimates in the S2 balance sheet should be extended by an additional factor meant to capture the elements of going concern that are left outside the S2 balance sheet. We draw attention to the fact that each of the above 3 features taken independently are insufficient to qualify illiquidity, but all of them play a significant role. It is also key to observe that a significant part of the (re)insurance undertakings’ liabilities are represented by own funds and that own funds fully respond to the definition of illiquidity. **Hence own funds should also be included in the scope of illiquid liabilities and in the scope of the survey.**	

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Q2	Life and non-life products should be included in the scope. It is also key to note here that not only the above products (life and non-life) should be included in the scope of illiquid liabilities but also own funds since own funds completely fulfil the features of illiquid liabilities (see Q1). Some unit linked portfolios, to some extent, can be included in the scope of illiquid liabilities. But in general can be excluded for the sake of this assessment and future data call.	
Q3	No, surrender risk should not be linked, since a general surrender risk of 40% is already captured. The relationship assumed is not seen in the recent history and is not backed by evidence. Furthermore, the Solvency ratio alone does not provide the policyholder with information on the sustainability of the insurer i.e to absorb adverse circumstances. Whether a deterioration has an impact on the solvency position of an insurer, if deemed material, is something to consider in the ORSA scenarios. Making lapse risk explicitly dependent on Solvency ratios creates 'cliff risk' and have countercyclical effects on the risk management at the micro-level.	
Q4	Yes, other characteristics are relevant. First, economic substance should prevail over legal substance. For instance, a typical renewable non-life one-year contract should be appreciated on a going concern basis that is including expected renewals. Moreover tax incentives may have a significant impact on surrenders. Policyholders may have incentives to postpone surrenders that are not contractual disincentives (e.g. French Situation).	
Q5	Yes, depending on the various national situations and practices, the tax features attached to an insurance product may be the paramount incentive / disincentive feature characterising the behaviour of policyholders. For instance, on the French market, many studies are available on the effect of tax disincentives and how they affect surrender rates. Evidence may be provided showing that surrender rates change when tax linked duration thresholds are crossed.	
Q6	Following answers to Q4 and Q5, we observe that undertakings are able to invest up to long-term horizons thanks to their going concern perspective. Similarly the effect of tax disincentive is strong and allows to allocate assets to longer maturities.	
Q7	For the majority of life insurance contract, i.e. savings and annuities contracts, mortality risk is not a relevant risk to cater for in the illiquidity assessment. And, with regard to longevity risk, this should	

	not be considered as a risk at all since it increases the length of the cash flows, i.e. one of the features of illiquidity.	
Q8	Unit linked are not always relevant, see Q2	
Q9	Macaulay duration is not sufficient to qualify the entire liquidity / illiquidity profile of a series of cash-flows. It is **a crude indicator** that do not consistently distinguish situations that may be materially different in the real life. Moreover, it is artificially truncated because of the lack of going concern approach in the prudential balance sheet. This is even more true in a period of stress, when the duration does not capture the complexity of the cash flow patterns and the management actions that may be enabled to smooth the effects of the stress.	
Q10	See Q9, Macaulay duration is a crude indicator for illiquidity/liquidity of insurance liabilities, it will be even worse if it is not computed on a going concern basis.	
Q11	Marginal effect of using option adjusted duration. The liabilities considered at portfolio level and even at homogeneous risk groups are diversified enough to avoid cliff effects at a given interest rate level that usually justify the use of option adjusted duration.	
Q12	In general, insurance products are pooled when it comes to investment decisions to allow for better diversification. In some specific situations, such as replicating portfolio or ring-fenced funds, assets may be segregated. This remains an exception rather than the rule. Accounting for FDB should not have a material impact on the duration.	
Q13	The assessment should be made on only one stress scenario combining both assets and liabilities. Such a stress will allow to understand the cash flow profile of the liabilities.	
Q14	See Q13. **We stress the fact that materiality and proportionality should be kept in mind and too many scenarios will prove to be burdensome and may confuse the message to be delivered.**	
Q15	First of all, **we favour an approach that would be consistent with tools already in place in Solvency 2 framework.** Rather than creating a new indicator “predictable part of liabilities” we suggest using the BEL. Moreover, the predictability is not to be appreciated through stress scenarios but over the accuracy of the cash flows used in the BEL. The predictability of cash flows is materially impacted by the going concern perspective and is	

	strongly interconnected with observed renewal rates. Finally, the methodology based on stress scenarios put forth by EIOPA is not applicable to non-life insurance.	
Q16	See Q15, we favour an approach consistent with the general framework of Solvency 2 so the cash flows are discounted with the RFR yield curve. Incidentally, we think that the point against discounting is flawed since there is no consistency in comparing cash flows occurring at very long intervals whatever their dependency may be to interest rates.	
Q17	See Q15 and Q16	
Q18	See Q15, an approach with stressed scenarios is not relevant.	
Q19	See Q15, an approach with stressed scenarios is not relevant.	
Q20	See Q15, an approach with stressed scenarios is not relevant, the BEL is computed over the time span of the contract.	
Q21	See Q15, an approach with stressed scenarios is not relevant.	
Q22	<u>About the data</u> : We strongly disagree with EIOPA statement that since only snapshots are available “the actual trading activity is underestimated” (see page 18). **Trading between two closing figures may have a wide range of reasons including accounting and fiscal considerations.** **Holding periods should be considered with substance prevailing over the form** : an operation of selling and buying back the same security immediately, performed for mere accounting or tactical reasons should not be accounted for in the holding period. We consider sensible to look at closing figures and data should not be blurred by inappropriate level of detail. <u>About the method</u> : Turnover is appreciated by looking at movements on individual assets. **This is a wrong approach from prudential point of view both for equities and bonds.** An undertaking selling a given asset and replacing it with another asset with similar characteristics (e.g. same maturity and CQS for fixed income, same industry and valuation ratios or performing better from an expert analysis point of view in the case of equities) experiences **turnover from an accounting point of view but not from**	

	an ALM point of view. Turnover should be measured to the extent that it changes the asset-liability balances. Turnover inside an asset class is the role of the asset liability manager when looking to optimize the performance of the clients. **Holding period is to be estimated on asset classes or buckets defined in such a way that they reflect the ALM.**	
Q23	See Q22	
Q24	See Q22	
Q25	Average maturity of the portfolio is a common indicator which is likely to be already available for most companies	
Q26	**No,** we consider these initial results not to be plausible. The figure 6 focusing on equity participations shows in our opinion the flaws in the methodology. It does not sound likely that undertakings sell their participations in proportions very similar to any other equities. In our opinion, this may be linked to operations performed for accounting rather than economical or ALM motivations.	
Q27	Regression should be performed at more aggregated level to be meaningful, see Q22	
Q28	No, we regret to read on page 27 that "life insurers typically try to match the cash flows of the long-term liabilities with cash flows from fixed income investments". First, the paper makes once again the confusion between long-term liabilities and long-term technical provisions. Non-life insurers do have own funds and do invest them similarly to what life insurers do. Moreover, depending on the line of business, non-life insurance technical provisions may extend to long horizons similar to those of life.	
Q29	Yes	
Q30	No, we wonder why migration are accounted for. In the case of a bond remaining in the portfolio, the migration has no effect on the cash flows as long as the bond does not experience default.	
Q31	No, see Q30	
Q32	Not relevant	

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Q33	No, when EIOPA states that “holding on to a portfolio of 5-years bonds for 5 years can be approximated by switching after 2 years from the 3-5 years indices to the indices with maturities up to three years”, we do not believe the economic reasoning behind this idea is always justified. **This reasoning is justified only for undertakings whose financial results account for unrealized financial gains.** Let us take an example, an undertaking buys at par a bond maturing in 5 years yielding 2.5%. For an undertaking whose accounting is based on acquisition cost, the financial results of this bond are known from the acquisition date up to the next five years with the only uncertainty of a possible default. **In this case, switching from an index to another does not make economic sense.** **Although valuing every asset at market value and taking market yield makes sense in the context of assessing a market value for the company, it does not give a reliable indication about the ability of the undertaking to hold its position over long period of time and discourages long -term investments.**	
Q34	No	
Q35		