

The Working Group on Sterling Risk-Free Reference Rates

Gabriel Bernardino
Chair
European Insurance and Occupational Pensions Authority
Westhafenplatz 1
60327 Frankfurt am Main
Germany

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Removal of Regulatory Barriers to IBOR transition and establishment of a pan-European Taskforce

Dear Mr Bernardino,

I am writing to you on behalf of the market-led Sterling Risk-Free Reference Rate Working Group (Working Group).¹ Earlier this year the Working Group constituted a Regulatory Dependencies Task Force to identify regulatory policy issues affecting the transition from IBORs to alternative risk-free rates. I welcome EIOPA's decision to add the monitoring of LIBOR transition to their general work on insurance RFRs². However, with known deadlines approaching, I would like to encourage EIOPA to go beyond monitoring transition to now actively removing the recognised Solvency II barriers to transition.

As members of the Sterling and Euro working groups have previously discussed with EIOPA, Solvency II regulations require insurers across Europe to value liabilities using "risk-free" discount rates which are typically derived from IBORs/LIBORs.

The FCA has secured agreement with the LIBOR panel banks to continue submissions until end-2021. But from this point onwards, LIBOR's continuation cannot be guaranteed, as the FCA does not intend to compel contributors to participate in the submission process after end-2021. Any resulting changes in the interest rate benchmarks used by EIOPA to derive 'risk free' discount rates will impact the value of insurers' liabilities, requiring recalibrations of associated investments including hedges. Further, we believe that if 'risk free' discount rates are derived from alternative risk-free rates, for example SOFR, €STR and SONIA, then the credit risk adjustment required under Solvency II will no longer be appropriate and will need to be rethought.

Presently European insurers have little clarity on the possible timeframe for any essential changes to the Solvency II risk free reference rates. We are concerned the absence of a timeline could act as an obstacle for insurers in their preparations for the transition through limiting the work they are able to do now to mitigate the risk in the future.

There is also a risk that liquidity in LIBOR derivative markets could markedly reduce sometime before the end of 2021, thereby rendering the existing Solvency II risk-free reference rates inappropriate for use sooner than many market participants may be expecting.

¹ The Sterling Risk-Free Reference Rate Working Group was convened by the Bank of England and the Financial Conduct Authority in 2015. The Working Group's overall objective is to catalyse a broad-based transition to Sterling Overnight Interest Average by end-2021, to reduce the financial stability risks arising from the widespread reliance of financial markets on LIBOR.

²https://eiopa.europa.eu/Publications/Reports/EIOPA_2018_SupervisoryActivities_April2019.pdf

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As a way to support European insurers in the management of the transition and to incentivise diligent risk management, an initial step could be for EIOPA to further raise visibility of IBOR/LIBOR transition by way of a specific public confirmation on the matter with broad timelines. The Working Group would also welcome clarity on whether the review of Solvency II in 2020 will consider these matters, or if EIOPA intend to use an alternative vehicle for change.

Working Groups to support EIOPA

The concerns I have outlined in this letter extend beyond LIBOR to EURIBOR, EONIA and €STR. Our Working Group has found it productive working with the Euro Risk-Free Rates WG on this matter, and I believe there is merit in establishing a pan-European Taskforce to foster and spearhead change. The Taskforce could work with EIOPA to provide constructive industry views and expertise to ensure that any change addresses these barriers. This proposal was originally made to EIOPA in the latter part 2018 and I would welcome an update on EIOPA's consideration on this matter.

I appreciate the opportunity to share these views and look forward to taking this forward with EIOPA. The Working Group are here to work with you on resolving the regulatory dependencies hindering the transition on LIBOR currencies to their new Risk Free Rates.

Sincerely,



Tushar Morzaria

Chair of the Working Group on Sterling Risk-Free Reference Rates