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Consultation paper on the revision of the Guidelines on Contract Boundaries

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1. INTRODUCTION

1. General comments

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We welcome those guidelines provided the financial and insurance discernible effect assessments remain proportionate.
Next to those guidelines, the Belgian experience where the supervisor issued a circular with an overview of the different products and expected contract boundaries turned out to be very useful. We believe that a similar initiative in the different Member States coordinated by EIOPA at EU level would ensure maximum convergence.
Generally, the inclusion of quantitative and qualitative market examples could help actuaries to understand the different scenarios undertakings may face when trying to set contract boundaries, especially for guidelines 6a and 6b.

Basically we see the need for a harmonisation of practices across the EU and also between Solvency II and accounting standards. This would help to reduce the workload considerably. For example in France, the accounting for savings contracts is carried out without future premiums in Solvency II and with future premiums in IFRS 17. This implies a doubling of models and production processes.

2. GUIDELINES

2. Guideline 0 (NEW) - Contract Boundaries

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We would welcome a clarification that the contract boundary is not a point in time, but should be considered as a boundary between premiums and claims which belong to the contract and those (premiums and claims) which do not.
We have understood this to mean that you should not cut off cash flows at the point of the boundary, but consider the legal obligation and as such, cash flows may extend beyond the date of the boundary of the contract.

3. Guideline 5 (AMENDED) - Unbundling of the contract

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We would welcome a clarification that unbundling is not necessary if the boundaries of both parts would be the same Ref to 3.10: Profit Sharing is an important case where projections are done globally over the different guarantees (not unbundled) but an unbundling takes place after allocation for valuation purposes.
Ref to 3.12: we do not support the statement according to which “dependencies at the level of premium usually do not prevent a contract from being unbundled”
• A distinction should be made between premium dependency and reserves dependency with dynamic allocation between general account and unit-linked where global risk of the contract differs from the ones in each compartment
• There are also cases of premium dependency with connected tariff as part of a global package where the additional coverage with this specific tariff could not be sold separately
• The contract definition with the agreed rights and obligations of each party can play a key role in the unbundling evaluation. A legal analysis should complement the risk and commercial assessment

4. Guideline 6a (NEW) - Identification of a financial guarantee of benefits with a discernible effect on the economics of a contract

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This guideline notes that “supervisory authorities may require a quantitative assessment from the undertaking and the result of this quantitative assessment should prevail.” Having to perform a quantitative assessment could prove quite onerous for some firms. It would be helpful if there was a materiality threshold, consideration of proportionality or further guidance related to when a quantitative analysis might be requested. Otherwise, there is a risk that all firms will be expected to perform a quantitative assessment. Also, in situations where a quantitative assessment is to be provided, it would be useful to give a sense of timelines for providing this to avoid firms feeling under pressure to have such an analysis readily available in advance of such a request from supervisors.

We would welcome a clarification in 2.7: Are these cash flows supposed to be projected using realistic assumptions which means that the projection of cash flows might go beyond any of the dates referred to in Article 18(3) of the Delegated Regulation? If yes, maybe this should be clarified in the paragraph.

We question the restriction that asset-dependant benefits in this assessment should be valued without any VA or MA if it is not the case under regular Best Estimate calculations. This would duplicate the work unnecessarily.

Para. 2.8 seems to take the customer’s perspective with regard to “financial advantage”, whereas in other paragraphs the company perspective is dominant. Hence, we suggest to alter para 2.8 and 2.9 in the following way:
2.8 Insurance and reinsurance undertakings should consider a financial guarantee of benefits as having a discernible effect on the economics of a contract only if the financial guarantee is linked to the payment of the future premiums and has a material effect on the undertaking. [delete: and provides the policyholder…]

2.9 When determining whether a financial guarantee has a discernible financial effect, insurance and reinsurance undertakings…

5. Guideline 6b (NEW) - Identification of a coverage for a specified uncertain event that adversely affects the insured person with a discernible effect on the economics of a contract

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We would welcome a clarification in 2.12:
Is any kind of business, type of product in the scope of this paragraph? Or is it casuistic? If so, to mention it explicitly would help actuaries/entities to identify this casuistic.

6. Guideline 6c (NEW) - Reassessment of the discernible effect of a cover or financial guarantee

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2.19: We would welcome an indication concerning the assessment of materiality.
What would EIOPA assess as a material impact on the valuation of technical provisions?
This could help actuaries to identify the threshold where further explanations are required.

3. EXPLANATORY TEXT

7. Explanatory text on Guideline 0 (NEW) - Contract Boundaries

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3.1 Consistency with IFRS17
We note that whilst there is no explicit reference to IFRS17, the wording in 3.1 is very similar to the wording in IFRS17.34. It is likely that most undertakings would welcome a clarification which aligns the treatment of contract boundaries between Solvency II and IFRS17.
3.2, 3.3: Cooling-off periods
Paragraph 3.3 could be interpreted as saying that contracts within their cooling-off period would not be included in the calculation of the TPs. “Either party can cancel” can be interpreted as saying that that contract is excluded from consideration if either one or both of the parties can cancel. A small revision to the wording might make this clearer, if this is not intentional – e.g.: “where both parties [each] have a unilateral right to cancel the contract during a limited period of time”.
We think it is important to consider the ’unilateral right’ of the undertaking to cancel. While this may be legally possible, market practice and public relations issues may make it so problematic for the insurance undertaking to cancel in the cooling off period that the contract is effectively legally bound.
Ref 3.3: in line with EU regulation, policyholders have the right to cancel their recently concluded contract during a limited period of time. Observations indicate that this right is however rarely exercised. This situation should be best captured via surrender rates and not via contract boundaries in line with proportionality to avoid significant systems and process impacts. 3.4 Projection periods
3.4 Projection periods
We believe that this is an appropriate clarification; in any case this is the standard approach in the non-life market in Ireland
Example 2 suggests that the contract boundary for the product in question could be longer than 8 years. However, given the ability of either party to terminate cover, our view is that an 8 year contract boundary should exist for this product.
Ref 3.7&3.8: example 2 can lead to confusion:
• It is not clear whether the discussion relates to reserves or future premiums projection
• If the prudent person principle is overarching, the level of interest rates could lead to different conclusion
The document mentions the general objective of alignment with IFRS17 (see par 4.29&4.50), whereas those products could qualify for long contract boundaries under the financial standard given the commercial relationship and the dependence on future guaranteed rates with previously granted rates

8. Explanatory text on Guideline 5 (AMENDED) - Unbundling of the contract

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9. Explanatory text on Guideline 6b (NEW) - Identification of a coverage for a specified uncertain event that adversely affects the insured person with a discernible effect on the economics of a contract

2500 character(s) maximum

Paragraphs 3.18 and 3.25 refer to ratios of 0.5% and 2% for deciding on whether features have a discernible effect, what is the status of these percentages? Are they provided purely as an example, with companies /supervisors permitted to use some discretion or are these percentages to be used in all cases? If it is the latter, how have these percentages been calibrated – we are not aware of any other thresholds in Solvency II that uses such percentages? Paragraph 3.25 also mentioned an additional 1% threshold where further qualitative analysis may be needed. Should this also be mentioned in 3.18 for consistency?

Ref to 3.21: we question that the proportion of the cover price should be expressed as a percentage of the annual investment management fees. This could be the case for unit-linked products but as stated in 3.13. It might not always be possible to unbundle unit-linked contracts with an insurance coverage (see also our comment on 3.14).

10. Explanatory text on Guideline 6c (NEW) - Reassessment of the discernible effect of a cover or financial guarantee

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It is important that this reassessment follows the proportionality principle (e.g. mapping with different contracts and some indicators) and does not result in undue financial instability.
Ref to 3.26: we understand that next to a change in economic environment, a change in regulatory environment could also trigger a reassessment.
Ref to 3.29: the situation is not clear to us. There is a distinction between universal life (where the guaranteed rate will apply until maturity) versus an annual guaranteed rate where the new rate will apply on existing reserves and new premiums).

4. IMPACT ASSESSMENT

11. Section 4.1. Procedural issues and consultation of interested parties

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12. Section 4.2. Problem definition

2500 character(s) maximum

13. Section 4.3. Objectives pursued

2500 character(s) maximum

Section 4.4. Policy Options

14. Section 4.4.1. Policy issue 1: Introduction of additional Guidelines vs status quo

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15. Section 4.4.2.Policy issue 2: Unbundling

2500 character(s) maximum

16. Section 4.4.3.Policy issue 3: Discernible effect

2500 character(s) maximum

Section 4.5. Analysis and impact of policy options

Section 4.5.1. Policy issue 1: Introduction of new Guidelines vs status quo

17. Policy option 1.1. Introduction of additional EIOPA Guidelines to provide clarity on how the calculation of technical provisions shall be applied by insurance and reinsurance undertakings.

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18. Policy option 1.2 Keeping the status quo of the current Guidelines.

2500 character(s) maximum

Section 4.5.2.Policy issue 2: Unbundling

19. Policy option 2.1 Contracts should be unbundled for valuation purposes where cash flows can be allocated to each part of the contract regardless of the (inter) dependencies among them.

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20. Policy option 2.2 Contracts should be unbundled for valuation purposes if and only if two (or more) parts of the contract are equivalent in terms of risk to two (or more) contracts that could be sold separately

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Section 4.5.3. Policy issue 3: Reassessment of the discernible effect

21. Policy option 3.1 Static contract boundaries. Whether a cover or financial guarantee has a discernible effect is determined at inception of the contract and does not depend on the economic environment.

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22. Policy option 3.2 Dynamic contract boundaries. Undertakings should perform a reassessment of the effect of a cover or financial guarantee where there is indication that it may lead to a different conclusion.

2500 character(s) maximum

This would appear to contradict the Delegated Acts, which refer to the SCR charges being derived as the "loss in basic own funds... that would result from" certain specified scenarios. “Changes in the scope of the valuation of best estimate” would likely change the best estimate, itself, which would affect own funds.

However, on a practical level, it may make sense to keep the contract boundaries constant throughout the assessment; the alternative is a number of iterative calculations of the best estimate liabilities under a number of scenarios. We note, in addition, the comments in 4.44 and 4.45 which expect this simplification to be immaterial.

Section 4.6. Comparison of Options

23. Section 4.6.1. Policy issue 1: Introduction of new Guidelines vs status quo

2500 character(s) maximum

24. Section 4.6.2.Policy issue 2: Unbundling

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25. Section 4.6.3. Policy issue 3: Reassessment of the discernible effect.

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ADDITIONAL COMMENTS

26. Please insert here any general comment not covered in the sections above.

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Explanatory text on Guideline 6a – Identification of a financial guarantee of benefits with a discernible effect on the economics of a contract:
We question the restriction that asset-dependent benefits in this assessment should be valued without any VA or MA if it is not the case under regular Best Estimate calculations. This would duplicate the work unnecessarily.
Ref to 3.14: we question the statement that the proportion of the guarantee price should be expressed as a percentage of the annual investment management fees. This could be the case for unit-linked products but as stated in 3.13. it might not always be possible to unbundle unit-linked contracts with an insurance coverage.
Ref to 3.15: this paragraph is unclear to us as to whether different scenarios should be considered depending on the length of the boundaries, which might result in a circular reference and disproportional workload.

Paragraph 3.18 refers to ratios of 0.5% and 2% for deciding on whether features have a discernible effect, what is the status of these percentages? Are they provided purely as an example, with companies /supervisors permitted to use some discretion or are these percentages to be used in all cases? If it is the latter, how have these percentages been calibrated – we are not aware of any other thresholds in Solvency II that uses such percentages? In this regard, we would welcome a clarification, that those thresholds are indicative, requiring expert judgement.

Contact

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