

Consultation paper on the revision of the Guidelines on the Valuation of Technical Provisions

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1. INTRODUCTION

1. General comments

2500 character(s) maximum

2. GUIDELINES

Expert judgement

2. Guideline 24a (NEW) - Materiality in assumptions setting

2500 character(s) maximum

24a–24e: The new guidelines introduce a requirement to implement a robust process regarding the material use of expert judgement in selecting assumptions for the TPs. It remains unclear if there is a threshold to identify a material use.

The new guideline 24a has been adopted from guideline 16 in EIOPA-BoS-14/180 EN (Guidelines on the use of internal models). It proposes to take into account 'extreme losses conditions'. This is understandable in case of an internal model which is intended to capture a one in 200 years loss. Guideline 24a applies to the valuation of technical provisions, which are calculated as the sum of a best estimate and a risk margin. We have reservations about importing the new expert judgement guidelines from the internal model guidelines explicitly into the technical provision guidelines on an almost 'verbatim' basis.

We don't think this sufficiently recognises proportionality and materiality. If expert judgements are used in the context of an internal model, then they are being used to set capital requirements in extreme scenarios. It doesn't seem proportionate to apply the same requirements in the context of best estimate scenarios.

Proportionality should be recognised in any new explicit technical provision requirements for expert judgements with the extent of work and documentation reducing the lower the significance of the assumption. It shouldn't be assumed that internal model expert judgement requirements are appropriate across the board for all companies/expert judgements.

The assumptions underlying the calculation of the best estimate liability should be best estimate assumptions taking into account all known facts and circumstances. Best estimate assumptions not based on expert judgement are typically derived from historical data. Indicators such as binary events, extreme events, and events that are not present in historical data are mentioned in the context of materiality. It seems arbitrary to take into account such events. Past events may actually be excluded from the data used to derive best estimate assumptions if they are statistically insignificant or are deemed to lead to assumptions inappropriate for the calculation of the best estimate. This could be clarified in par.2.2.

Should emerging trends also be considered? Such trends may be starting to become evident in the historical data but may not yet have fully emerged so judgement is needed as to the direction of travel and ultimate position of the trend.

3. Guideline 24b (NEW) - Governance of assumptions setting

2500 character(s) maximum

The approval of material assumptions up to the administrative, management or supervisory body appears disproportionate. In most cases, the validation by technical committees and eventually by the management board should be sufficient while informing the administrative board.

Paragraph 2.5: We would welcome a clarification of EIOPA's view concerning sufficient seniority

4. Guideline 24c (NEW) - Communication and uncertainty in assumptions setting

2500 character(s) maximum

The guideline states that "The insurance or reinsurance undertaking should make transparent the uncertainty of the assumptions as well as the associated variation in final results." Where is this transparency expected to be communicated?

Also, paragraph 2.7 states that "The insurance or reinsurance undertaking should establish a formal and documented feedback process between the providers and the users of material expert judgement and of the resulting assumptions." Could clarity be provided on who the "users" are in this guideline and what is intended by a "formal and documented feedback process"?

5. Guideline 24d (NEW) - Documentation of assumptions setting

2500 character(s) maximum

In the context of standalone documentation of assumptions requiring expert judgement, more clarity on assessing materiality would be very useful. In the extreme, most decisions in reserving and assumption setting can be considered to have an element of expert judgement. If the assessment of materiality is vague and open-ended, then there is a risk of divergent practices across undertakings in this regard, undermining the aim of convergence.

Paragraph 2.12: Are those users of material assumptions the same as the users of the output obtained through the use of those assumptions? Board of directors / Steering Co.? We would welcome a clarification.

6. Guideline 24e (NEW) - Validation of assumptions setting

2500 character(s) maximum

Paragraph 2.13. Examples of potential validation process in the explanatory text might be helpful to clarify the expectation.

Biometric risk factors

7. Guideline 24e (AMENDED) - Modelling biometric risk factors

2500 character(s) maximum

Expense allocation

8. Guideline 28a (NEW) - Investment management expenses

2500 character(s) maximum

Guideline 28a suggests that investment expenses should be required in respect of both technical provisions plus SCR. We don't fully agree that SCR should be included in this consideration. Firstly, you end up with circularity if you include risk margin and SCR in the calculation of the best estimate as these items are a function of the best estimate and cannot be calculated until the BEL is known.

Furthermore, most firms target a level of solvency coverage above 100% so allowing for investment management expenses related to the SCR would still not capture the full level of expenses firms incur in managing their business.

Additional considerations are that:

— Article 31 of the Delegated Regulation refers to expenses, in cash flow projections, which relate to recognised insurance and reinsurance obligations. The SCR is a capital requirement, not a (re)insurance obligation, hence there may be an inconsistency here.

— In broad terms, technical provisions should represent the amount that another undertaking would require in order to take on and fulfil the insurance liabilities. Including expenses associated with the SCR within this may not be comparable from firm to firm.

If the investment management expenses associated with the SCR (and RM) are to be included, we would welcome some guidance on how to avoid circularity.

Ref. to paragraph 3.6: it does not seem appropriate to take all investment expenses due to circularity with TP. If the investment expenses proportion proves stable over time, it should be possible to take only that percentage.

9. Guideline 30 (AMENDED) - Apportionment of expenses

2500 character(s) maximum

Modelled expenses should consider in the case of run off companies aspects, which are genuine to this company strategy. This means especially IT lifecycle periods and their future investment necessities. We also refer to our comments to the EIOPA CP on supervision of Run-Off-undertakings.

There are insurance companies that have a coverage period of one year but the damage cannot occur uniformly during the coverage period due to boundary conditions. Examples are hunting liability insurance, where damage can only occur in the hunting year, or liability insurance for shows. This should be indicated by amending paragraph 2.25 c) accordingly (taking into account specific features of tariffs if material).

10. Guideline 33 (AMENDED) - Changes in expenses

2500 character(s) maximum

We note that the reference to inflation in the Guideline 33 appears reasonable. In particular, the current economic environment is such that the impact of inflation is more significant than in previous years; it is therefore reasonable that this should be adequately captured in the expense calculation.

Referring to Paragraph 3.14: Inflation assumptions should be consistent with other economic assumptions. We question whether explicit inflation scenarios should be developed or some regression techniques would provide an appropriate solution.

Treatment of financial guarantees and contractual options

11. Guideline 37a (NEW) - Dynamic policyholder behaviour

2500 character(s) maximum

Data on Dynamic behaviour is very difficult to acquire and requires a huge volume of events to calibrate accurately. It is also very difficult to monitor base lapse rates and dynamic lapse rates separately as they are intertwined. Therefore, introducing a requirement to model dynamic behaviour will be quite difficult for most firms and we believe any effort to do this will rely heavily on expert judgement.

Furthermore, decrements like lapses or annuity take-up rates can be impacted by a variety of external issues. This has been compounded over the last 18 months as a result of the pandemic. To that end setting assumptions based on "statistical and empirical evidence, where it is representative of future conduct," is almost impossible to do.

We question whether this guideline would also require dynamic lapse modelling in some health coverage where legally indexed premiums could result in unaffordable contracts for policyholders. However, we expect some proportionality principle here while there should be consistency within the whole modelling.

Paragraph 2.28: When dealing with extreme scenarios lacking of data is common. Stressing one case, i.e. treatment of dynamic policyholder behaviour, should seem to be redundant. Therefore we question the need of this guideline.

12. Guideline 37b (NEW) - Bidirectional assumptions

2500 character(s) maximum

13. Guideline 37c (NEW) - Option to pay additional or different premiums

2500 character(s) maximum

This guideline refers to modelling the option to pay additional premiums. However, some such additional premiums could fall outside the contract boundary. It would be helpful if clarification could be given relating to how to interpret this guideline in the context of contract boundaries and also if some examples of the types of additional premiums that should be modelled could be given. For example, our view is that top-ups on single premium business are generally not modelled as they are treated as new business – is this interpretation correct?

Aside from that, we believe that determining the amount of future additional premiums to allow for would be extremely subjective and subject to significant variability in actual vs expected over time.

There are contract changes or changes to the contract which do not trigger additional payments or premium changes to a significant extent. Such should only have to be taken into account if they are of material. This should be clarified in the wording of 2.30

General comment: Additional premiums have to be within the contract boundaries. We refer here to our comments to the CP concerning contract boundaries.

There are contract changes or changes to the contract which do not trigger additional payments or premium changes to a significant extent. Such should only have to be taken into account if they are of material. Suggestion for wording for 2.30

Paragraph 2.30: Insurance and reinsurance undertakings should model all material contractual options when projecting the cash flows, including the option to pay additional premiums or to vary the amount of premiums to be paid, where the undertaking should estimate the amount of voluntary premiums expected to be received and the related obligations within the contract boundaries.

General comment: Additional premiums have to be within the contract boundaries. We refer here to our comments to the CP concerning contract boundaries.

Future management actions

14. Guideline 40a (NEW) - Comprehensive management plan

2500 character(s) maximum

The new proposals for future management actions in Guidelines 40a & 40b related to the requirement to have a comprehensive approved management plan in this regard, and also that new business should be considered appropriately in this process. Our view was that typically future management actions are relatively small in number for non-life business and that therefore this wouldn't be overly onerous.

We note that Guideline 40a remains consistent with Article 23 of the Delegated Acts and gives additional detail on the form of the documentation in this regard. This suggestion appears reasonable. However, we note that there may be some divergence in practices in relation to which assumptions are considered to relate to Future Management Actions. Generally, our view is that there are limited examples of assumptions within the non-life context which are deemed to relate to Future Management Actions and that in general these will relate to reinsurance purchase only.

This guideline would seem to not add much to existing requirements.

Paragraph 2.31: We would suggest to clarify that prescribed requirements should only be relevant for those management actions considered in the valuation of technical provisions.

15. Guideline 40b (NEW) - Consideration of new business in setting future management actions

2500 character(s) maximum

Paragraph 2.32 states that „insurance and reinsurance undertakings should consider realistic assumptions on new business in setting future management actions”. Paragraph 3.23 explains the idea with an example: “However, if the undertaking adapts its assumptions to realistic expectations on future business, the undertaking would base its assumptions on realistic expectations on future business, e.g. assume that the duration of the liabilities and the assets will remain stable”.

In our view it is necessary to adjust the bonds duration to the duration of the modelled in-force business in order to avoid non-consistent management actions which could lead to a large overestimation of capital market risks.

We would welcome a view as to how the level of new business should be set. It is likely that new business will align with the company's business plan. However, the new business levels in such a plan might be set at optimistic levels to drive performance. Should companies consider past performance vs planned new business levels and adjust for that?

Best Estimate should be projected on run-off including underlying investments.

Depending on the business, it should be taken into account that projecting new business could result in different liability durations where a duration matching should not be captured in pillar 1 calculations.

Summing up “realistic assumptions on new business in setting future management actions” must not result in unrealistic management actions.

Methodologies for the valuation of contractual options and financial guarantees

16. Guideline 53a (NEW) - Use of stochastic valuation

2500 character(s) maximum

This guideline lacks proportionality. The requirement to perform stochastic modelling could be quite onerous for smaller companies. It would be helpful if there could be some clarity given in relation to the definition of “material options and guarantees” – are these material in the context of a product or the company in question? Perhaps there could be some allowance for proportionality or simplifications e.g. using uplifts to assumptions to allow for uncertainty rather than performing a full stochastic run in some cases.

Stochastic valuation for any contract with guarantee or surrender should not be requested. The existence of SCR for related risks (financial and surrender) combined with alternative analyses (sensitivities, stress testing under ORSA) could provide appropriate solutions.

We should also ensure consistency with internal model requirements.

There are very small sub-portfolios with essential options and / or guarantees which, however, have no material impact on the total result of the technical provision, for example, portfolios of accident pensions to be paid due to accident benefits. In accordance with Article 56 DR 2015/35, a stochastic evaluation of the interest rate guarantee may be disproportionate. This should be considered in paragraph 2.33.

Solvency II-review 2020: We would like to refer to Commission’s proposed treatment of proportionality and the low risk undertakings as part of the proposed amendment so the Solvency II framework and recommend an alignment with these.

Economic Scenario Generator

17. Guideline 57a (NEW) - Market risk factors needed to deliver appropriate results

2500 character(s) maximum

Paragraph 2.36: when referencing Economic Scenario Generators (ESG), the guidelines say "In particular and among others, undertakings should consider: using models that allow for the modelling of negative interest rates." We propose using a stronger language here as opposed to "undertakings should consider". We would expect a very strong justification that the model is fit for purpose if negative interest rates are not modelled.

Expected Profits In Future Premiums (“EPIFP”)

18. Guideline 77 (AMENDED) - Assumptions used to calculate EPIFP

2500 character(s) maximum

This guideline introduces in Paragraph 2.39. the actuarial function validation of EPIFP. This seems to be not in line with article 48 of the Solvency II Directive and article 272 of the Delegated Regulation. We believe that there is currently no such requirement. It seems strange to introduce a validation requirement in guidelines rather than in the Delegated Regulation which sets out the responsibilities of the Actuarial Function.

We note that Guideline 77 appears to address divergent practices and in particular the explicit reference to overhead expense assumptions remaining unchanged which appears reasonable. However, it is somewhat surprising that the proposal includes no specific additional guidance relating to unbundling of the business and segmenting into profitable and loss-making cohorts.

19. Guideline 78 (NEW) - Alternative approach to calculate EPIFP

2500 character(s) maximum

In the context of Guideline 78, we suggest that additional guidance on how it should be determined that the calculation in Guideline 77 should be considered “too complex”. In the absence of more specific guidelines in this regard, this may result in divergence of practices.

3. EXPLANATORY TEXT

Expert judgement

20. Explanatory text on Guideline 24a (NEW) - Materiality in assumptions setting

2500 character(s) maximum

We welcome the clarification (in the explanatory text relating to Guideline 24a) relating to consideration of events not present in the historical data – and that the requirements of SII are that the best estimate consider the outcome of all possible scenarios, not just reasonably foreseeable scenarios. This would include climate and political changes in line with the product coverage duration and using expert judgement as to the possible evolutions of those risks (e.g. maturity level of the regulatory evolutions, adjusting historical data when appropriate).

Biometric risk factors

21. Explanatory text on Guideline 24e (AMENDED) - Modelling biometric risk factors

2500 character(s) maximum

Expense allocation

22. Explanatory text on Guideline 28a (NEW) - Investment management expenses

2500 character(s) maximum

23. Explanatory text on Guideline 30 (AMENDED) - Apportionment of expenses

2500 character(s) maximum

Paragraph 3.11 of the explanatory text says that "Undertakings should not consider short-term strategies to depart from recent expense analysis". We think there should be a caveat here in cases where recent expense analysis does not accurately reflect future expenses. For example, if significant project costs occurred in the past and will no longer take place, or if the company has implemented a plan to reduce costs and this can be thoroughly documented/justified.

In the text box, we understand that the following correction should apply in the last paragraph:

Without prejudice to ..., in order to allocate expenses,

24. Explanatory text on Guideline 33 (AMENDED) - Changes in expenses

2500 character(s) maximum

Treatment of financial guarantees and contractual options

25. Explanatory text on Guideline 37a (NEW) - Dynamic policyholder behaviour

2500 character(s) maximum

Future management actions

26. Explanatory text on Guideline 40a (NEW) - Comprehensive management plan

2500 character(s) maximum

27. Explanatory text on Guideline 40b (NEW) - Consideration of new business in setting future management actions

2500 character(s) maximum

Methodologies for the valuation of contractual options and financial guarantees

28. Explanatory text on Guideline 53a (NEW) - Use of stochastic valuation

2500 character(s) maximum

Expected Profits In Future Premiums (“EPIFP”)

29. Explanatory text on Guideline 77 (AMENDED) - Assumptions used to calculate EPIFP

2500 character(s) maximum

An amendment to Guideline 77 is being proposed which clarifies some issues around divergent practice in the context of the EPIFP calculation. We noted these as reasonable; however, it was pointed out that there appears to be a lack of guidance on unbundling in this regard.

A simplified approach is introduced in a new guideline (Guideline 78); we commented that this may lead to divergent practices.

4. IMPACT ASSESSMENT

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

2500 character(s) maximum

In the context of Guidelines 30 and 33, we note that the point made in paragraph 3.12 appears sensible. This could be extended to explicitly reference known material future projects which will incur significant expenses attributable to technical provisions. A relevant example of this is IFRS 17 projects, where significant additional expenses may be incurred in comparison to previous years. Furthermore, it may be worth clarifying that a sensible approach should be taken with regard to “commitments on or before valuation date” referred to in Guideline 33.

31. Section 4.2. Problem definition

2500 character(s) maximum

32. Section 4.3. Objectives pursued

2500 character(s) maximum

Section 4.4. Policy Options

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

2500 character(s) maximum

34. Section 4.4.2. Policy issue 2: Consistent approach regarding use of expert judgments for both technical provisions and internal model

2500 character(s) maximum

35. Section 4.4.3. Policy issue 3: Proportion of investment management expenses to be considered

2500 character(s) maximum

36. Section 4.4.4. Policy issue 4: Management of expenses that the fund manager reimburses to the undertaking

2500 character(s) maximum

37. Section 4.4.5. Policy issue 5: Detailed guidance on the calculation of EPIFP

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

38. 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.

2500 character(s) maximum

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

2500 character(s) maximum

Section 4.5.2. Policy issue 2: Consistent approach regarding the use of expert judgments for both technical provisions and internal model

40. Policy option 2.1. Introduction of a full set of guidelines on Expert judgment for the valuation of technical provisions

2500 character(s) maximum

41. Policy option 2.2. Introduction of a reference to the guidelines on Expert judgment for internal model purposes in a specific guideline

2500 character(s) maximum

42. Policy option 2.3. Reference to guidelines on Expert judgement for internal model purposes in the recitals (current situation)

2500 character(s) maximum

Section 4.5.3. Policy issue 3: Proportion of investment management expenses to be considered

43. Policy issue 3: Proportion of investment management expenses to be considered

2500 character(s) maximum

Section 4.5.4. Policy issue 4: Management of expenses that the fund manager reimburses to the undertaking

44. Policy issue 4: Management of expenses that the fund manager reimburses to the undertaking

2500 character(s) maximum

Section 4.5.3. Policy issue 3: Proportion of investment management expenses to be considered

45. Policy option 5.1: Clarification on the assumptions to be used to calculate EPIFP

2500 character(s) maximum

46. Policy option 5.2: No further clarification

2500 character(s) maximum

Section 4.6. Comparison of Options

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

2500 character(s) maximum

48. Section 4.6.2. Policy issue 2: Consistent approach regarding the use of expert judgments for both technical provisions and internal model

2500 character(s) maximum

49. Section 4.6.3. Policy issue 3: Proportion of investment management expenses to be considered

2500 character(s) maximum

50. Section 4.6.4. Policy issue 4: Management of expenses that the fund manager reimburses to the undertaking

2500 character(s) maximum

51. Section 4.6.5. Policy issue 5: Detailed guidance on the calculation of EPIFP

2500 character(s) maximum

ADDITIONAL COMMENTS

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

2500 character(s) maximum

Contact

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