Actuarial Association of Europe: Response to EIOPA Consultation on mass-lapse reinsurance and reinsurance termination clauses to enhance guidance on risk mitigation techniques – 7 February 2025

General

Q1.1. Do stakeholders see the need for detailed guidance on mass-lapse reinsurance and-or for other reinsurance structures or clauses?

Highlight as necessary: No / Yes / **Yes, but less detailed / more high-level**

Q1.2. If yes, which reinsurance structures and why?

We believe that guidance on mass-lapse reinsurance (MLR) is necessary to ensure consistent application of Solvency II principles and harmonised approvals by National Supervisory Authorities (NSAs). MLR has grown in popularity, and specific guidance can enhance convergence across Member States. Key areas for guidance include calibration of attachment points, use of external data to complement limited observed data, and scenario analysis to model rare but extreme events where historical data may be insufficient. Improved clarity would reduce differences in supervisory interpretation and prevent legal uncertainty. However, guidance should focus on MLR, as most other structures are well-established or bespoke, making additional guidance impractical. Collaborative discussions among regulators, insurers, reinsurers, and advisors could also help to develop practical solutions.

Q1.3. Please provide any necessary additional comments related to Question to stakeholders 1:

We do not see the need for detailed guidance on MLR. The guidance should remain principle-based to allow market participants to tailor solutions to their specific risk profile and operational characteristics, maintaining regulatory compliance and adaptability. Reiterating the core principles of effective risk transfer and the management of basis risk can contribute to a harmonised treatment. Some safeguards surrounding items such as termination clauses, allowance for renewals in the risk margin calculation etc. could contribute to a consistent treatment at a lower cost.

For now, we believe guidance should focus on mass-lapse reinsurance, while other reinsurance structures remain adequately addressed by existing frameworks or are too niche for detailed guidance. We would suggest that guidance should not be accompanied by additional regulatory requirements.

Mass-lapse reinsurance (section 3)

Q3. Please provide any general comments to the Annex on Mass-lapse reinsurance (section 3)

We welcome EIOPA's guidance on mass-lapse reinsurance (MLR), which provides a reasonable framework for assessing these arrangements against regulatory requirements. We appreciate the focus on effective risk transfer as this helps ensure a consistent approach across the EEA. The emphasis on special termination triggers and contract certainty is also valuable for aligning risk mitigation techniques with supervisory expectations.

However, we note the importance of retaining a principles-based approach, as assessments need to be performed on a case-by-case basis to reflect the diversity of underlying risks and reinsurance arrangements. This flexibility allows insurers and reinsurers to tailor solutions to specific portfolios while ensuring compliance with prudential regulations.

Guidance which aims to improve consistency, should ideally avoid excessive repetition of existing legal requirements. This could create unnecessary complexity. Regarding the example, it should be explicitly stated that underlying assumptions ensure compliance with prudential regulations. However, adherence to the specifications in the document does not guarantee compliance with all prudential regulations. A clearer definition is necessary to avoid misinterpretation.

Clearer definitions, particularly in the appendix, would help avoid misinterpretation and ensure alignment with regulatory standards without adding undue complexity.

We note that overly prescriptive or unbalanced proposals could inadvertently increase costs or create uneconomic cliff-edge effects that hinder market efficiency and access to reinsurance. Collaborative discussions among stakeholders, including regulators, supervisors, insurers, reinsurers, and advisors, could complement guidance to ensure practical solutions that balance risk transfer and affordability.

Overall, we recommend that guidance focus on addressing specific issues in relation to MLR, including clarifications on basis risk and alignment with the SF, while avoiding unnecessary detail that could distort the market or complicate implementation.

Q4. Section 3.1: Description of the case. Paragraphs 3.1 to 3.6

Some AAE members raised concerns about aspects of the Opinion. Par 3.5 suggests that lapses triggered by an event could manifest over periods longer than a year, but some examples to support this would be welcome (e.g., reputational damage with lasting effects beyond 12 months where the treaty is not triggered).

We would like to noted that the wording in Par 3.6 should be aligned with Article 142(6)(b) DR by restricting it to the policies where technical provisions increase.

We note product distinctions in Par 3.11: for life insurance, profitability loss dominates, while savings products face liquidity risks. Guidance should address these differences to support effective treaty design. Lastly, Par 3.16 should clarify that best estimate assumptions must remain objective without influence from MLR.

Q2.1. Would any of the options have any impact in your case? Please briefly describe the reasons why.

Most mass-lapse reinsurance (MLR) treaties already use a rolling 12-month measurement period. Formalising this as the standard under Option 2 would align with existing practices and have minimal impact. In contrast, extending the measurement period to 24 months under Option 1 could create significant challenges. These include increased reinsurance premiums, reduced capacity, and lower solvency coverage across the EEA unless treaties are renegotiated. Renegotiation would also introduce costs and administrative complexity, potentially destabilising the market for such cover.

The Delegated Regulation (DR) defines mass lapse as an instantaneous shock within a 12-month framework, while long-term lapse trends are addressed under the lapse-up scenario. These distinct risks are already appropriately captured in the current framework. Extending the observation period risks undermining Solvency II principles, as mass lapse events are sudden and catastrophic, not gradual or extended over time. An attempt to extend the concept beyond one year would contradict the SCR's forward-looking 12-month horizon, which forms the basis of Solvency II's risk assessment framework.

Practical concerns with Option 1 include difficulties in attributing lapses beyond 12 months to a specific mass lapse event. This could lead to disputes between insurers and reinsurers about whether such lapses belong to the initial event or a new risk. Legal uncertainty and misalignment between risk transfer and capital relief may arise as a result, potentially reducing market confidence in these treaties.

Option 2 avoids these issues by preserving the clear distinction between mass lapse and long-term lapse risks. It aligns with Article 142 of the DR and the principles of the standard formula, which considers risks over a 12-month horizon. Furthermore, shorter observation periods, even less than 12 months, may better reflect customer behaviour during crises, as evidenced by historical examples, and support the logic of current practices.

Members emphasised the importance of clear guidance to ensure alignment with the DR and consistency in reinsurance contract negotiations. Divergent regulatory requirements could complicate treaty design and disrupt market practices. Providing clearer definitions for mass lapse risks and measurement periods would help strike a balance between practical implementation and regulatory compliance while maintaining the integrity of Solvency II principles.

In conclusion, we support Option 2 as it aligns with existing practices, maintains Solvency II principles, and avoids the operational, legal, and financial challenges associated with Option 1.

Q2.2. Which additional pros, cons or additional considerations (if any) would you like to highlight for one or both options?

Our members highlighted several considerations for Options 1 and 2 regarding observation periods for mass-lapse reinsurance (MLR) treaties.

Many members favour Option 2, which aligns with current market practices and the Solvency II Standard Formula (SF). Most MLR treaties already use rolling 12-month periods, and introducing longer measurement periods, as per Option 1, would require significant changes to existing treaties, creating disruptions in solvency calculations and risk management strategies.

Moreover, Option 2 reduces regulatory arbitrage by allowing continuous treaty coverage for SCR calculations, as opposed to fixed measurement windows that could result in partial credit only at specific times.

Option 1 poses several challenges. Extending the measurement period to 24 months introduces potential basis risk, liquidity mismatches, and confusion between mass lapse and lapse-up risks, which are distinct and already captured by current rules. A longer period may also lead to disputes about attributing lapses occurring after 12 months to a mass lapse event, increasing legal uncertainty and operational risks. Some members noted that longer periods might not align with reinsurers' risk appetite, potentially reducing capacity and increasing premiums.

Option 2 also offers advantages in liquidity management and risk alignment. With quarterly rolling measurement periods, reinsurance claims can be determined and settled more frequently, reducing time lags between events and claims, mitigating liquidity and counterparty default risks. This approach also enables periodic adjustment of reinsurance parameters to reflect changes in the ceding undertaking's risk exposure, ensuring treaties remain effective under evolving conditions.

Some AAE members raised concerns about material basis risk. Some observed that the real issue lies in the inconsistency between risk reductions achieved by certain treaties and the associated SCR relief, rather than basis risk as defined in the Delegated Regulation. They suggested the

Opinion should focus on ensuring commensurate risk reduction rather than emphasising material basis risk alone.

In conclusion, we support Option 2 as it aligns with market practices, mitigates operational and liquidity challenges, and maintains consistency with Solvency II principles. Option 1, while conceptually possible, introduces unnecessary complexity, legal uncertainty, and practical challenges, which could adversely affect insurers and reinsurers.

Q5.1. Section 3.1: SCR treatment. Comments to the blue box

We agree with EIOPA's emphasis on effective risk transfer as a key principle for the SCR treatment of mass-lapse reinsurance (MLR). Regular reporting on the appropriateness of such treaties is an essential part of the ORSA process, ensuring that the risk mitigation technique remains aligned with the undertaking's overall risk profile and solvency needs. Additionally, ongoing assessment and reporting on the effectiveness of the risk transfer should be a core element of the undertaking's risk management framework.

Q5.2. Section 3.1: SCR treatment: Paragraphs 3.17 to 3.21

We note that Par 3.17 to 3.21 largely summarise existing legal requirements under SII and previous EIOPA guidance. While this reinforces alignment with established rules, it should be clear that the lack of MLR-specific clarification does not create new obligations.

It should be confirmed that the list of factors influencing lapse risk in 3.1 are not comprehensive. Other factors influencing lapse risk can be the economic conditions or the quality of service.

Q6.1. Section 3.3.1: Clear and incontrovertible terms and conditions: Comments to the blue box.

[N/A]

Q7.1. Section 3.3.2: Lapse definition and basis risk. Comments to the blue box

EIOPA could consider changing or removing this section, as it sets disproportionate expectations and risks creating unnecessary operational burdens by requiring comprehensive definitions for discontinuances that do not pose material solvency risks.

Reinsurance treaties are negotiated contracts between sophisticated parties, designed to align with specific risk exposures. Some treaties cover the full range of discontinuances under Solvency II, while others are tailored to particular portfolio risks. The proposed guidance appears inconsistent with Article 210(1) Solvency II DR, as it overlooks cases where tailored definitions effectively mitigate basis risk without adhering strictly to the "discontinuance" definition in Article 1(14).

Q7.2. Section 3.3.2: Lapse definition and basis risk. Paragraphs 3.22 to 3.25

As long as the contractual lapse definition is clear and incontrovertible and meets the requirements of Article 210(1) of the Solvency II Delegated Regulation, there is no basis risk from the definition itself.

Moreover, narrower definitions in MLR treaties (e.g., those aligned with industry standards) should not be problematic, as the implied lapse rate will still reflect at least the level of discontinuance required under Solvency II.

Q8.1. Section 3.3.3: Exclusions Comments to the blue box

We believe guidance on contractual language should strike a balance, recognising that such language is essential for ensuring risks meet the criteria for (re)insurability. It could prove unrealistic to expect contracts to omit rights or protections for either party, or "overall exclusions" should not automatically be equated with material basis risk.

If guidance is necessary, we recommend a broad description of appropriate practices rather than specific examples that could imply a blanket objection to such clauses.

Additionally, EIOPA appears to distinguish between two types of exclusions: those linked to events within the ceding undertaking's control, which do not constitute material basis risk, and those linked to events outside their control, which may create basis risk. We would ask EIOPA to make this distinction more explicit, ensuring clarity for stakeholders if this section is retained in the MLR Annex.

Q8.2. Section 3.3.3: Exclusions. Paragraphs 3.26 to 3.30

We support the principle of minimising moral hazard in reinsurance agreements, including through reasonable exclusions, such as for internal transfers within an insurer. However, exclusions should only be deemed problematic if they result in material basis risk. If it is sufficiently substantiated that an exclusion does not lead to material basis risk, the risk transfer should be considered effective.

Internal switching, as referenced in Paragraph 3.26, should generally remain excluded, as it is often influenced by the ceding undertaking and difficult to differentiate from events beyond its control. Additionally, internal switching typically does not result in losses above the attachment point of an MLR treaty.

The statement in Paragraph 3.30, suggesting that treaties lacking close mirroring of changes fail to provide effective risk transfer, could be misinterpreting Guideline 1. Not closely mirroring does not inherently indicate basis risk.

Q9.1. Section 3.3.4: Basis for the calculation of the claim. Comments to the blue box

We agree that the use of Solvency II parameters simplifies the SCR calculation and aligns with best practices. However, where MLR treaties define claims using non-Solvency II parameters,

these should be accepted if sufficient explanation demonstrates that differences between treaty recoverables and Solvency II losses do not create material basis risk.

We would welcome a confirmation that EIOPA's concern is limited to instances where differences between treaty recoverables and actual portfolio losses up to a 1-in-200 event (as per the undertaking's own scenarios) introduce material basis risk. This understanding would ensure proportionality and avoid overly rigid interpretations that may limit practical treaty design.

We also note the importance of consistent use of parameters for defining claims, attachment, and detachment points, as this alignment avoids unnecessary complexity and ensures accurate risk transfer.

Q9.2. Section 3.3.4: Basis for the calculation of the claim. Paragraphs 3.31 to 3.34

We do not have any material comments and do not see a need for further guidance on this aspect. However, it may be useful to provide clarity on what constitutes a profit-sharing arrangement to ensure consistent interpretation across Member States.

Q9.3. Section 3.3.4: Basis for the calculation of the claim. Example of different basis for calculation

[N/A]

Q10.1. Section 3.3.5: Fixing parameters. Comments to the blue box

[N/A]

Q10.2. Section 3.3.5: Fixing parameters. Paragraphs 3.35 to 3.37

This section would benefit from a more detailed explanation of the different parameters which are being discussed in the context of basis risk. For example, best estimate lapse rates, attachment point and the basis for calculation of lost value in the event of mass lapse event (interest rate levels, fund performance etc).

Q11.1. Section 3.3.6: Cliff-edge effect. Comments to the blue box

[N/A]

Q11.2. Section 3.3.6: Cliff-edge effect. Paragraphs 3.38 to 3.41

We note the concern raised in the Opinion that treaties transferring losses only above the attachment point (AP) could result in 100% capital relief for the mass-lapse SCR. However, this assumes that the mass lapse SCR fully aligns with the losses covered by the treaty, which may not always be the case. An MLR treaty covering losses for a 40% lapse rate only when observed lapses exceed the attachment point (AP) is not equivalent to the event modelled in the standard formula, and for this example a full capital relief may not be achieved.

Q12.1. Section 3.3.7: Attachment / Detachment point. Comments to the blue box

We would question the need for regular oversight on APs, as they are assessed during risk transfer evaluations for capital relief. Specifying AP levels may be unnecessary and could complicate treaty implementation.

We generally agree with the guidance but note there could be challenges for companies with limited historical data, e.g., to develop an appropriate lapse distribution or provide sufficient proof of effectiveness. Using historical lapses to define VaR 99.5% scenarios is meaningful only if such data reflects significant changes in lapse behaviour. Where this is unavailable, market/regional data or hypothetical scenarios could be used.

Undertakings should perform scenario analyses not only in the ORSA but also before entering into MLR treaties to evaluate SCR reduction.

Q12.2. Section 3.3.7: Attachment / Detachment point. Paragraphs 3.42 to 3.45

We suggest reviewing this section to ensure consistent expectations for attachment points, avoiding disparities based on portfolio characteristics like historically low lapse rates, which may not reflect future risks. Linking attachment points to business scope may contradict Solvency II's uniform 40% stress assumption.

While we support flexibility in attachment points, a qualitative approach considering insurer-specific circumstances might be more suitable than rigid specifications.
Scenario analyses considering all relevant facts should assess whether the real risk reduction aligns with the SCR reduction. Insurers should apply judgement to confirm commensurability of the risk transfer, using probability distribution forecasts, even under the Standard Formula.

Where no material basis risk exists, attachment points should ensure commensurate risk transfer, akin to Solvency II's acceptance of out-of-the-money put options for equity risk.

Q13.1. Section 3.3.8.1: Measurement period and renewals. Comments to the blue box

[N/A]

Q13.2. Section 3.3.8.1: Measurement period and renewals. Paragraphs 3.46 to 3.49

We note that this section includes references or allusions suggesting that reinsurers should provide coverage extending beyond a 12-month period. We propose removing such references to maintain alignment with the Solvency II framework, which is based on a one-year time horizon for the SCR calculation.

The current wording could create ambiguity, potentially leading to misinterpretations regarding the expected duration of coverage under mass-lapse reinsurance treaties.

Q14.1. Section 3.3.8.2: Liquidity risk. Comments to the blue box

The section primarily discusses liquidity management processes, which are broader considerations for undertakings rather than issues directly related to MLR. While liquidity risk is an important area of risk management, its treatment in this section does not add significant value to the discussion on mass-lapse reinsurance treaties. As a result, it seems to be outside the scope of the intended focus of the opinion.

Q14.2. Section 3.3.8.2: Liquidity risk. Paragraph 3.50

It seems that, as this exposure to liquidity risk is also the case for most or all Nat Cat reinsurance treaties, the paragraph does not seem to contain anything specific to MLR-treaties.

Q15.1. Section 3.3.9: Early termination clauses. Comments to the blue box

[N/A]

Q15.2. Section 3.3.9: Early termination clauses. Paragraph 3.51

Early terminations usually provide flexibility to both reinsurers and cedants, enabling either party to end the reinsurance earlier if necessary. For instance, some triggers for early termination allow parties to renegotiate treaty terms when there is a material change in risk, ensuring that the original intent of the treaty is preserved.

We disagree with the description of the early termination clauses in this text, as it may not fully reflect the principle of good faith upon which reinsurance treaties are typically executed.

Q15.3. Section 3.3.9: Early termination clauses. Example early termination

[N/A]

Q16.1. Section 3.3.10: Special termination clauses. Comments to the blue box

We understand that the blue box does not provide specific clarification or guidance tailored to mass-lapse reinsurance (MLR). Instead, it reiterates existing regulatory requirements under Article 210(2) of the Solvency II Delegated Regulation (DR), which already apply broadly and are not specific to MLR.

Q16.2. Section 3.3.10: Special termination clauses. Paragraphs 3.52 to 3.55

We agree that special termination clauses can result in indirect exclusions that may affect the efficiency of risk transfer. However, some scenarios require careful consideration to address potential moral hazard by the ceding company, particularly in relation to its distribution

activities. Exclusions or special termination rights may be necessary in such cases to ensure the integrity of the MLR arrangement.

Increased scrutiny of termination clauses and their enforceability can reduce market capacity in certain segments. Special termination rights, which are standard in reinsurance contracts, are often crucial for managing moral hazard. E.g. Reinsurers should not be expected to maintain coverage if the insurer cannot sustain its operations or where lapsation is induced by the insurer, directly or via 3rd-party actions. Similarly, it is inappropriate for an insurer to claim on the MLR if policyholders are retained under alternative products outside the treaty's scope (switching).

Q16.3. Section 3.3.10: Special termination clauses. Example special termination clause

[N/A]

Q17.1. Section 3.3.11: Estimating the risk-mitigating effect. Comments to the blue box

[N/A]

Q18.1. Section 3.4: Reinsurer's perspective. Comments to the blue box

Although we generally agree with the comments, it is worth noting that some reinsurers that accept the mass lapse risk have an internal model approved which would be used for determining the mass lapse capital requirements to the underlying direct insurance contracts.

These reinsurers will determine appropriate capital to be held for the undertaking. However, it is important to ensure that this capital assessment aligns with a robust understanding of the real risk reduction for the cedant, ensuring the two perspectives are commensurate. While there may be differences between the undertaking's and the reinsurer's capital determination methods, this should not detract from the reinsurer's obligation to fulfil its commitments in the event of a mass lapse.

Furthermore, reinsurers maintain robust exposure management, limits, and monitoring practices, to ensure that risks are effectively managed and capital requirements are met.

Q18.2. Section 3.4: Reinsurer's perspective. Paragraphs 3.56 to 3.57

[N/A]

Q19.1. Section 3.5: Balance sheet. Comments to the blue box

We support the guidance to ensure consistency between the risk margin calculation and the cost of reinsurance renewals. It can help to promote coherence and accuracy in the valuation of reinsurance recoverables.

Assessing the mass-lapse reinsurance market liquidity poses a significant challenge, particularly over long-time horizons. This is accompanied by substantial uncertainty, necessitating a prudent choice of the assumptions regarding renewals and costs.

Guidance for addressing these challenges could enhance alignment across different reinsurance arrangements.

Q19.2. Section 3.3.10: Balance sheet. Paragraphs 3.58 to 3.65

We note the wide scope of requirements for determining reinsurance market liquidity and estimating the cost of replacing reinsurance arrangements. While we welcome the flexibility afforded to entities in estimating these parameters, it can be difficult for individual entities to assess the overall reinsurance market. This is an area that may benefit from additional guidance.

It is important to avoid overly optimistic assumptions, particularly regarding market liquidity. A mass lapse event could coincide across multiple undertakings, leading reinsurers to withdraw future cover, exposing companies to increased SCR due to the loss of risk mitigation beyond the contract boundary.

The risk margin can significantly impact own funds. Overly optimistic assumptions can lead to an exaggerated improvement of the solvency position. Clear principles for the risk margin calculation can help to ensure prudence and alignment with the legal term of MLR treaties.

Reinsurance agreements' termination clauses (section 4)

Q20. Please provide any general comments to the Annex on reinsurance agreements' termination clauses (section 4)

Basically, we support EIOPA's efforts to address the implications of termination clauses in reinsurance agreements and their impact on effective risk transfer.

Some considerations:

- Reinsurance may not always remain effective in extreme scenarios. Termination clauses should therefore account for such instances without undermining the overall intent of the treaty.

- A distinction should be made between losses incurred before or after the event (the "event") that gives rise to the reinsurer's extraordinary termination of the contract. Reinsurers should remain liable for losses incurred before the event. If a reinsurer can refuse to pay such losses under the terms of the contract, this would undermine the effective transfer of risk. However, if the reinsurer is not liable for losses incurred after the event, this alone does not necessarily invalidate the effective risk transfer unless other factors indicate otherwise.

- We note that upon insolvency of the insurer or reinsurer, the Solvency II valuation and SCR calculations based on market-consistent principles can become void due to the cessation of the going concern assumption (IRRD will offer different tools that might be chosen). The same may apply under certain national supervisory measures. The going concern assumption may remain valid depending on the nature of these measures.

- We note that insolvency and supervisory measures should not be viewed as entirely outside the control of the undertaking, as they often follow a lengthy process. Corrective actions could be taken to prevent insolvency (or the supervisory measures).

- Termination clauses serve as essential contractual features that balance the rights and obligations of both parties throughout the treaty's term. They reduce litigation risk by clarifying which risks are covered, aligning with the requirements of Article 210(1) of the Solvency II Delegated Regulation (DR).

- It is also important to recognise that extraordinary termination is often permissible under most legal systems, even if not explicitly stated in the contract. Limiting such rights could introduce non-transparent provisions and legal uncertainty. Furthermore, the treatment of reinsurance treaties in the event of the primary insurer's insolvency is subject to varying jurisdictional legal requirements, which would take precedence over contractual terms.

Q21. Section 4.1: Description of the case. Paragraphs 4.1 to 4.4

We would suggest revising the description to clearly define the scenarios EIOPA has in mind, avoiding ambiguity. Specifically:

- Clarify that termination clauses, including those linked to insolvency, do not automatically impair risk transfer under SII.

- Provide greater precision for terms such as "reinsurance treaty period" (paragraphs 4.2 and 4.3), specifying whether it refers to the original treaty term or the period up to termination. Similarly, "incurred losses" (paragraphs 4.2 and 4.3) could clarify if it includes losses up to the termination date or also future losses under the original treaty term.

Q22. Section 4.2: Analysis of the case. Paragraphs 4.5 to 4.10

We suggest further clarification on how termination clauses are expected to operate in practice, particularly regarding their forward-looking or retrospective application. Specifically, it would be helpful to confirm whether EIOPA expects termination to apply solely on a forward-looking basis—i.e., excluding new business or new claims reported after the termination date—or whether it could also apply retrospectively to risks already underwritten. While paragraph 4.7 implies this may depend on the specific treaty, explicit guidance would be valuable to reduce ambiguity.

Additionally, it should be clarified that clauses establishing a present value-based termination settlement in the event of insolvency or administrative actions by a competent regulatory body should be deemed as effectively transferring risk. Such clauses ensure the payment of legitimately incurred losses and the overall settlement of the treaty at the “value” of the agreement as of the termination date. The settlement amount could be payable by either the reinsurer or the ceding company, depending on the terms of the reinsurance contract. Recognising such clauses as consistent with effective risk transfer would provide practical flexibility while maintaining policyholder protection and aligning with Solvency II principles.