RAB response to EIOPA's consultation on mass-lapse reinsurance and reinsurance agreements' termination clauses

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Contact person:	RAB secretariat	E-mail:	international@insuranceeurope.eu
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General comments

The Insurance Europe Reinsurance Advisory Board (RAB) welcomes the opportunity to provide comments to EIOPA's consultation on the annexes to the opinion on the use of risk mitigation techniques (RMT) by insurance undertakings: mass-lapse reinsurance (MLR) and reinsurance agreements' termination clauses.

The RAB appreciates EIOPA's efforts to provide guidance on assessing the efficiency of risk transfer and the balance between risk mitigation and solvency capital relief. We further welcome EIOPA's acknowledgement that *"Reinsurance is an important tool for capital and risk management used also for risk diversification, access to additional underwriting capacity for portfolio expansion, addressing the protection gaps and increasing the financial stability. It plays a crucial role in the insurance industry's ability to operate and provide coverage to individuals and businesses."*

Since the introduction of Solvency II, there has been a substantial pooling (ie diversification across the insurance system) of mass-lapse risk on reinsurers' balance sheets, which has directly supported the insurance sector and indirectly enhanced both financial stability and policyholder protection. In this context, the RAB welcomes EIOPA's endeavours to support an appropriate and convergent supervision of MLR.

At the same time, the RAB calls for caution with respect to overly prescriptive and unbalanced proposals, particularly where such proposals risk unintended effects of making it difficult for an insurer to appropriately manage and mitigate its risks. For example, the RAB agrees that consideration of any basis risk is clearly an important and necessary step. It is equally important to not end up with an overly restrictive guidance. It should therefore be clarified that the guidance provided strictly refers to MLR, and extensions to other RMT are not planned to avoid unintended negative economic effects on the reinsurance market in general. The RAB calls instead for a more principle-based approach in line with the binding regulation.

In the context of the Solvency II framework, it is generally recognised that the design of the standard formula may not always fully capture either the risk or the RMT in a technically perfect way. Aware of such limitations, the RAB itself has long argued for a more accurate recognition of non-proportional reinsurance in the standard formula.

Insurance Europe's Reinsurance Advisory Board
Secretariat • rue du Champ de Mars 23, B-1050 Brussels
Tel: +32 2 894 30 00
E-mail: international@insuranceeurope.eu

In the RAB's view, the consultation proposals, as currently drafted, take a binary approach to reinsurance contract recognition in the standard formula, which:

- **Risk undermining the Solvency II framework** and the principles on which it is based, notably with respect to the one-year time horizon. This would create uncertainty for undertakings not only relating to MLR but also to the future direction of EIOPA's interpretation of Solvency II.
- May fail to **properly recognise the holistic nature of Solvency II** which was designed with the understanding that there are limitations in the standard formula. Doing so may result in an undesirable mismatch between the valuation of inbound risk and the capital recognition merited from the RMT of the same risk.

Regarding the proposed Annex on MLR, the RAB's key recommendations are as follows:

1) Maintain the one-year horizon measurement period. An extension of the measurement period beyond 12 months would unnecessarily blur the lines between the instantaneous shock risk (mass-lapse) and the long-term trend risk "lapse-up" (permanent increase in lapse rates) and create potential double-counting of risks in the SCR.
2) Align the description of the material basis risk text with the binding delegated act (DA). The Solvency II DA provides a clear definition of material basis risk, which is assessed at the BSCR level[1]. All references to material basis risk in the Annex should be made with regards to the Solvency II DA Article 210(3) to ensure that materiality is assessed at the appropriate level of granularity. The reference to the basis risk guidelines is redundant and potentially misleading if interpreted in the Annex as requesting a more granular assessment than the one required in Article 45 of the Directive and Article 210 of the delegated act.
3) Align the description on attachment/detachment point with the binding regulation, in particular Article 45 of the Solvency II directive and Article 210 of the Delegated Regulation. Specific expectations on attachment points would be disproportionate as what matters is whether the standard formula Solvency Capital Requirements (SCR) properly reflects the risk profile after reflecting the entirety of the risk mitigation technique (as opposed to each component of the treaty).
4) Acknowledge that exclusions and termination clauses are often necessary and acceptable to ensure an operational and equitable contractual relationship, which preserves the parties' original commercial intention and the economic effect of the treaty. They strengthen the executability of treaties and are in the interests of both cedents and reinsurers. Similarly, termination clauses contribute to insulate the treaty from litigation risk between the parties. The RAB supports a reconsideration of this wording to better recognise these points and the role of such clauses. Restricting the use of such clauses could create possibilities for moral hazard that could ultimately translate into reinsurance as a risk management tool becoming unavailable.
5) Avoid introducing any new provisions in Annexes to the 2021 Opinion that would add to the current documentation framework. This is critical to ensure proportionality, notably when assessing the materiality of the basis risk. Examples include:
    - Paragraphs 3.18, 3.21, 3.24, 3.29, 3.45, and Sections 3.3, 3.3.2, 3.3.3, 3.3.4, 3.3.5, 3.3.7, 3.3.10 propose additional documentation requirements for companies that use MLR. In the RAB's view, Section 12 of the 2021 Opinion already provides a robust approach for assessing the effectiveness of the risk mitigation from mass-lapse reinsurance arrangements.

[1] The definition of material basis risk per article 210 (3) of the Delegated Act states that: "Basis risk is material if it leads to a misstatement of the risk-mitigating effect on the insurance or reinsurance undertaking's Basic Solvency Capital Requirement that could influence the decision-making or judgement of the intended user of that information, including the supervisory authorities."

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Regarding the Annex on reinsurance termination clauses, the RAB would like to make the following recommendations:

- It should be made clear that this section (similarly to the rest of the paper), only applies to the effect of these clauses on the appropriateness of standard formula results, recognising internal model users' capacity to model specific treaty features where appropriate and as provided for in Article 235 of the Solvency II Delegated Act.
- Recognise that termination clauses in general serve legitimate risk management purposes and do not compromise an effective transfer of risk.
- More generally, the RAB is concerned about the potential scope of this section. It is the understanding of the RAB that EIOPA wants to set guidance on very specific and rare termination clauses where the reinsurer is released of its obligation to pay "legitimate" claims upon the occurrence of predefined events. Because the concept of "legitimate claims" can be misinterpreted or misconstrued, the RAB urges EIOPA to provide additional clarification, outlined in more detail below.

Additional feedback on specific sections of the consultation paper is outlined below.

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Question to stakeholders

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

Options: No / Yes / **Yes, but less detailed (more high-level)**

The RAB agrees with EIOPA that there are currently divergences in supervisory practices towards mass-lapse reinsurance that need to be addressed. The main example of divergence revolves around the expected length of the risk measurement period, on which EIOPA is requesting feedback. The RAB welcomes EIOPA's initiative to provide clarity and supervisory convergence on this fundamental question which goes beyond mass-lapse reinsurance and relates to the core principles of Solvency II. Beyond that important point, a principle-based approach instead of a detailed guidance would be more useful to achieve greater consistency and convergence in the approaches followed by insurance supervisors within Europe.

In essence, Section 3.3.11 is sufficient:
Undertakings signing MLR treaties as risk mitigation techniques should ensure that, when calculating the loss in basic own funds resulting from the events described in article 142(6) DR, the risk-mitigating effect can be accurately measured considering the specific terms and conditions of the MLR treaty, which frequently requires a detailed analysis of the case and granular considerations.

In view of making the Annex more concise, accessible and specific to its convergence objective, the RAB suggests in the rest of the response several places where points or paragraphs could be removed.

In this context, the RAB considers that no other types of reinsurance structures would require specific guidance on supervisory convergence grounds.

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

Please refer to the above. The RAB considers that no other types of reinsurance structures would require specific guidance on supervisory convergence grounds.

Section 3: Mass-lapse reinsurance

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

- In light of the general comments above, the RAB would like to make the following recommendations, detailed in the rest of the response:
  - The RAB considers that the Annex should clarify that it strictly refers to MLR.
  - The RAB's strong view is that a measurement period longer than 12 months is not a necessary feature of MLR, or other RMT. The use of a 12-month measurement period is not in itself creating basis risk.
  - The RAB does not support the use of the "mirroring" and recommends replacing it by a reference to Article 210(3) of the Delegated Act and Paragraph 12 of the Opinion on RMT to which this Annex is appended.
  - The RAB supports the removal or, at the very least, significant revision, in a risk-based manner, of the expectations regarding the definition of lapse.
  - The RAB supports a more balanced messaging on basis risk in the context of exclusions and the removal of the list of examples.

- The RAB supports the removal or, at the very least, significant revision in a more proportionate manner of the section on attachment point, and recommends refraining from commenting on or giving examples of specific level of attachment.
- The RAB recommends clarifying that the guidance on early termination clauses targets a specific and narrow scope.
- The RAB recommends that EIOPA removes the section on special termination clauses to ensure the continuity of legitimate risk management practices and the proper functioning of the mass-lapse reinsurance market. Instead, Section 4 of the Annex on termination clauses would apply to mass-lapse treaties.

Section 3.1: Description of the case

Q4. *Section 3.1: Description of the case*

Paragraphs 3.1 to 3.6

- The RAB welcomes clarification if there is a specific scope: the wording of Paragraphs 3.1 and 3.3 imply a focus on specific products potentially only relevant to specific markets, ie interest rate sensitive (savings) products.
- Paragraph 3.5 states that "lapses triggered by an event can manifest over a longer period than a year". While this is a plausible theoretical scenario, there are limited real-world examples to use as evidence to draw conclusions, including regarding the statement "Especially if the lapses are a reaction to a 1 in 200 event, some lapses may not occur within the next 12 months". It is equally arguable that advancements in technology will result in policyholder reactions that are far quicker than the 12 months period, as was the case in recent banking crises.
- Paragraph 3.6 offers an example attachment point of 15%. EIOPA should clarify that this is not to be interpreted as guidance for a regulatory expected level, or a maximum acceptable level.

Section 3.2: Feedback request

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

The RAB's strong view is that a measurement period longer than 12 months is not a necessary feature of MLR, or other RMT. The use of a 12-month measurement period is not in itself creating basis risk.

- The RAB agrees with the original Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) definition of mas- lapse, quoted in Paragraph 3.4 as a *"temporary and drastic rise of lapse rates"* over a *"limited span of time"*. Consistent with this, the scenario-based calculation for mass-lapse is described in Article 142(6) as the loss in basic own funds, resulting from a combination of instantaneous mass-lapse events. Under this definition, the RAB strongly believes the typical MLR treaties written to date have appropriately captured sufficient risk coverage to continue qualifying for the calculated capital relief.
- In addition, the design of Solvency II includes both the standard formula as the pillar 1 model for a theoretical average company and pillar 2 aspects to support pillar 1.
- An extension of the measurement period beyond 12 months would unnecessarily blur the lines between the instantaneous shock risk (mass-lapse) and the long-term trend risk "lapse-up" (permanent increase in lapse rates) and create potential double-counting of risks in the SCR. These are two distinct risks which are already appropriately captured and managed in the existing rules, including in both SCR (Article 142) and own risk and solvency assessment (ORSA) where necessary.

- Ultimately, a binary regulatory intervention to disqualify such capital relief would not be reflective of the economic reality of the transfer of risk occurring under such MLR and could also potentially conflict with the underlying assumptions of the standard formula in its entirety.

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

- There is no demand for Option 1 and existing ML treaties would not align with that option. Given that there does not exist MLR with measurement periods longer than 12 months, implementing a requirement to adjust the minimum period would require a change to all existing reinsurance agreements, resulting in a change in solvency calculations.
- The RAB does not believe that Option 1 is a viable solution as it singles out reinsurance and undermines the principles and practical application of the standard formula for one specific circumstance. In so doing it risks creating significant regulatory uncertainty for the insurance industry regarding the future direction and interpretation of the standard formula, beyond the specific point under consideration in this paper. The application of the standard formula must be consistent with existing regulations.
- Notwithstanding what is justifiable, there is also a question of what is possible. For example, from an operational perspective, the RAB considers that longer than 12 month measurement periods would also have negative consequences on the timeliness of reinsurance claim payments, as reinsurers would need additional best estimate lapse rates to be calculated. In addition, with respect to lapses that occur after 12 months, it is difficult to distinguish whether they belong to an event that occurred during the first 12 months (and belong to the mass-lapse reinsurance claim) or to an event that occurred after the first 12 months (and do not belong to the reinsurance claim). It creates legal uncertainty and may lead to disputes between the reinsurer and the ceding company.

Section 3.3: SCR Treatment

Q5.1. *Section 3.3: SCR treatment?*

Comments to the blue box.

The RAB does not support the use of the "mirroring" and recommends replacing it by a reference to Article 210(3) of the Delegated Act and Paragraph 12 of the Opinion on RMT to which this Annex is appended.

- This "mirroring" approach considers that, to avoid basis risk, the change in the value of the RMT closely mirrors the change in the value of the risk exposure in different scenarios. It may be appropriate in the context of proportional reinsurance but is inappropriate in the context of non-proportional reinsurance. A non-proportional treaty responds to the claims when they attach; in this case the fact that the MLR cover does not mirror the risk exposure in all scenarios is by design and therefore should not be a reason to disqualify an MLR as an RMT. What matters is whether the risk mitigating effect is adequately reflected in the overall SCR based on the assumptions of the standard formula.
- Instead, the RAB urges EIOPA to highlight and rely on the test required in the binding regulation per Article 210 (3) of the Delegated Act: "*Basis risk is material if it leads to a misstatement of the risk-mitigating effect on the insurance or reinsurance undertaking's Basic Solvency Capital Requirement that could influence the decision-making or judgement of the intended user of that information, including the supervisory authorities*." In this regard, the 2021 Opinion on RMT has the merit to be closer to the intention of the binding regulation: whether a risk mitigation strategy would lead the calculated SCR to deviate significantly from the underlying assumptions of the standard formula in such manner that it would no longer reflect the risk profile of the cedent.

- Therefore, the RAB suggests that the reference to the EIOPA guidelines on basis risk be replaced by a reference to Article 210(3), and if necessary, to Paragraph 12 of the 2021 Opinion throughout the paper.
- Further points are noted in Q5.2.

Q5.2. *Section 3.3: SCR treatment*

Paragraphs 3.17 to 3.21

The RAB does not agree with Paragraph 3.19 and recommends it is deleted.

- In particular, the RAB does not consider that a change in the "risk mitigating capacity" (understood to mean a change in the proportion of the gross-of-MLR mass-lapse risk covered by the MLR since the inception of the MLR contract) should be classified as basis risk resulting from the MLR. The undertaking's calculation of capital relief under its SCR calculations would naturally adapt to adequately reflect the coverage in place as at the date of the SCR calculation.
- Furthermore, the intent of Section 3.35 "Fixing Parameters" appears to conflict with Paragraph 3.19.
- In addition, the RAB notes:
  - Paragraph 3.17 "Undertakings willing to utilise MLR treaties should have in place a specific risk management assessment concerning surrenders and the discontinuance options that they are more exposed to according to their materiality." It is not clear for what purpose this specific risk management assessment is to be used or why it is only valuable to undertakings who utilise MLR.
  - Paragraph 3.18 "undertakings should include scenarios at 99.5% where the mass-lapse event is likely to but does not occur or where other financial risk factors changed (e.g., spread risk)". The RAB does not understand the meaning of scenarios that are likely but do not occur.
- Furthermore, the test defined in the 2021 Opinion is whether a particular treaty would lead the calculated SCR to deviate significantly from the underlying assumptions of the standard formula in such manner that it would no longer reflect the risk profile of the cedent. What is requested in Paragraphs 3.17 to 3.21 is different if MLR is utilised. EIOPA should therefore clarify the expectations by requesting cedents to ensure that their SCR captures their risk profile appropriately.
- EIOPA should refrain from referring to explanatory text on the Guidelines on Basis risk to not mislead the readers in believing that they form part of the body of Solvency II regulation.

Q7.1. *Section 3.3.2: Lapse definition and basis risk.*

Comments to the blue box

The RAB supports the removal or, at the very least, significant revision of this section in a risk-based manner.

- The definition of "discontinuance" in the Solvency II Delegated Regulation is descriptive but not indicative of a risk. A discontinuance as defined in Solvency II does not necessarily equate to a loss of basic own funds, and, if it does, the magnitude of the loss can vary. This is recognised by Article 142(6) of the Delegated Regulation, namely: *"the undertaking shall base the calculation on the type of discontinuance which most negatively affects the basic own funds of the undertaking on a per policy basis"*. In other words, there cannot be a material basis risk if certain types of discontinuances, while not covered by the treaty, have limited or no impact on the solvency of the cedent.
- Definitions of "lapse" in treaties aim at covering those discontinuances which, in the context of the cedent, represent a risk that therefore needs to be transferred. For example, for certain investment-based insurance products where the investment risk is borne by the insurer, the main risk with a

mass-lapse event is the potential materialisation of losses through forced sales of assets, notably in a context of rising interest rates. If a treaty covering this product does not consider its transfer to another product within the insurer as a lapse, this does not automatically mean that there is a (material) basis risk since, as per Article 142(6), this transfer would not entail a sale of assets and therefore would not *"negatively affects the basic own funds of the undertaking"*.

- The proposed guidance is setting disproportionate expectations and risks creating unnecessary operational burdens in terms of requiring a comprehensive definition including for the case of discontinuances which do not create solvency risks. In addition, these disproportionate expectations deviate from the underlying assumption of the mass-lapse SCR in Article 142(6) of the Delegated Regulation.

Q7.2. *Section 3.3.2: Lapse definition and basis risk*

Paragraphs 3.22 to 3.25

In addition to the response to Q7.1:

- Paragraph 3.21 – while the intention is understood, the RAB believes that undertakings should have flexibility to make their own assessment of the wording most suitable to their business. In particular, the additional operational burden required to capture less common and less impactful policyholder actions in many cases does not justify implementing a more comprehensive wording.
- Regarding Paragraph 3.24, depending on the nature of the products and their materiality, it may not be proportionate and relevant in the context of the materiality of the risk for the undertaking to carry out an assessment of scenarios with different exercise rates for different types of discontinuance options. EIOPA should refer to a proportionate assessment in its wording here.
- Paragraph 3.25 does not appear to add to the statement made in 3.24.

Q8.1. *Section 3.3.3: Exclusions*

Comments to the blue box

The RAB supports a more balanced messaging on basis risk and the removal of the list of examples.

- The RAB believes that any guidance on contractual language should be balanced, reflecting the valid and essential purpose that contractual language achieves, including in ensuring the risk meets the usual criteria for being (re)insurable by the reinsurer. It is not realistic to expect a contractual relationship to contain no rights or protections for one party. Where guidance is necessary, we would expect that, rather than implying a wide-ranging objection to such contractual language through examples, a broad description of what is appropriate is included.
- The purpose of exclusions is to ensure that the treaty responds solely to risks that the parties intended to cover (and the reinsurer price), to reduce litigation risk by making the treaty clearer, and, crucially, to align interests between parties. In summary, exclusions strengthen the executability of treaties and are in the interests of both cedents and reinsurers.
- Therefore, the RAB recommends caveating the first sentence by saying that "Undertakings should verify if exclusions in MLR treaties may create basis risk".

Q8.2. *Section 3.3.3: Exclusions*

Paragraphs 3.26 to 3.30

- In general, the RAB supports reinsurance agreements whereby moral hazard is minimised and alignment of interests between the insurer and the reinsurer is supported. Many of the standard agreements in place today are a result of many years of reinsurance supporting the operation of the

insurance sector. Where EIOPA's proposed guidance acts to open possibilities for moral hazard, there is a significant risk that reinsurance as a risk management tool becomes unavailable. A clear distinction should be made between what is within the cedent company's control. There should be a strong preference for exclusions to only apply as a result of actions within the control of the insurance company or their partners, which results in a misalignment of risk.

- In addition, such guidance can create a damaging precedent that could affect other forms of reinsurance agreements. As in every synallagmatic contract, the obligations of each party to a reinsurance contract necessarily depend on the obligations of the other.
- Specifically in relation to the examples presented in the consultation paper:
  - It is not clear how a reinsurance, or any other contract, can continue to function if the insurer is unable to maintain its operations.
  - It would be inappropriate for an insurer to benefit from its own actions in recommending lapsation, including via third parties it contracted with.
  - It would be inappropriate and likely unnecessary for an insurer to claim on the MLR in the event policyholders are retained under an alternative product not in scope of the MLR (switching).
- Therefore, the RAB recommends removing the list of examples in Paragraph 3.26.

Q9.1. *Section 3.3.4: Basis for the calculation of the claim*.

Comments to the blue box

Please refer to the response to Q9.2 and Q9.3

Q9.2. *Section 3.3.4: Basis for the calculation of the claim.*

Paragraphs 3.31 to 3.34

- Paragraph 3.34 introduces changes in interest rates over the MLR measurement period as an example of a MLR basis risk. The RAB strongly disagrees with this as changes in interest rates are and should be treated as an interest rate risk, already well addressed by the relevant Solvency II provisions. As per the RAB's observation on 3.19: changes in the risk mitigating capacity, in this case arising from interest rates, should already be managed by the SCR calculation and should not be classified as a basis risk. In addition, updating exposure at the start of the measurement period is already implicitly allowing for the cover to function under a different interest rate environment, and depending on the exposure, insurers can always seek for additional unused capacity to manage for interest rate up scenario.
- In general, the RAB has observed a "locked-in" approach in the market with parameters fixed at the start of measurement periods which is an effective way to transfer the mass-lapse risk without including other risks that the parties do not intend to transfer. There are also often overlapping measurement periods, which limit any potential impact of changes to locked-in parameters.

Q9.3. *Section 3.3.4: Basis for the calculation of the claim.*

Example of different basis for calculation

- The boxed example focuses on the best estimate lapse rates (not considered in the paragraphs that preceded it). It is not clear what the merit of this example is. In principle, the RAB would not automatically see a basis risk resulting from an alternative but equivalent claim definition ("best estimate (5%) + 20%" versus fixed "25%"), recognising that this feature can be adequately reflected

in the insurer's SCR calculations simply by modelling the reinsurance claim amount under the SCR mass-lapse stress.

Q10.1. *Section 3.3.5: Fixing parameters?*

Comments to the blue box

Please refer to the response to Q10.2.

Q10.2. *Section 3.3.5: Fixing parameters*

Paragraphs 3.35 to 3.37

- In general, the RAB agrees with the description in Paragraph 3.36 that provides for a predictable MLR structure which is typical in the market. However, the RAB would not say alternatives necessarily create a material basis risk.
- In Paragraph 3.37 (and in 3.55) the consultation document states that materiality of basis risk should be set before considering diversification after aggregation. This is not consistent with the Delegated Regulation description of materiality in Article 210 which refers to a misstatement of the SCR influencing the decisions or judgement of the users of the information.

Q12.1. *Section 3.3.7: Attachment / Detachment point.*

Comments to the blue box

The RAB supports the removal or, at the very least, significant revision of this section in a more proportionate manner and recommends refraining from commenting on or giving examples of specific levels of attachment.

The RAB strongly recommends the Annex is revised to align the description on attachment/detachment point with the binding regulation, in particular Article 45 of the Solvency II directive and Article 210 of the Delegated Regulation.

Like for "Put" options in the context of financial markets where the non-linearity of the strike price and option price is widely accepted, there is no such a thing as a "too low" or "too high" level of attachment. Therefore, EIOPA should refrain from commenting on or giving examples of specific levels of attachment.

Heightened expectations singling out attachment points would be disproportionate as what matters is whether the standard formula SCR properly reflects the risk profile after reflecting the entirety of the risk mitigation technique (as opposed to each component of the treaty). The RAB believes that EIOPA should rather encourage undertakings to keep in mind the requirement to perform the SCR adequacy and standard formula appropriates assessment per Article 45 of the directive when setting the attachment point.

If Section 3.3.7 is maintained (not the preferred option), the RAB recommends to replace the blue box and Paragraph 3.44 and 3.45 as follows: *"An undertaking's assessment of the adequacy of the standard formula for its risk profile in the ORSA should have regard to the underlying mass-lapse risk profile and the mass-lapse reinsurance in place where they are material for the aggregate required capital of the firm. This requirement should be considered by the undertaking when setting the attachment point."*

Q12.1. *Section 3.3.7: Attachment / Detachment point.*

Paragraphs 3.42 to 3.45

- It is not clear to the RAB why there should be further regulatory oversight of the attachment point, which is already considered for any assessment of risk transfer and associated capital relief. In principle, if the inbound risk is to be quantified at 40% then it must follow that any attachment point below 40% is reducing the risk of the insurer, as defined by Solvency II, and as such should qualify as capital relief. Whether the undertaking is expecting to be exposed to a low or high mass-lapse risk does not change this fact. But one could even consider that if mass-lapse reinsurance allows to reduce the SCR in line with the low mass-lapse risk exposure of the company, then the RMT has achieved a better adequacy of the SCR with the risk profile of the company.
- Paragraph 3.43 discusses reinsurance pricing and concludes that pricing and transfer of risk are two different assessments as different pricing structures can achieve commensurate capital relief. The RAB agrees with this and considers that pricing should be left to the commercial decision of the parties involved.
- Paragraph 3.44 is inconsistent with Paragraph 3.43 when it states "*a too high attachment point might endanger the balance between risk transfer and capital release*" without justifying this assertion. Paragraph 3.44 then highlights a weakness of the standard formula, namely the stress scenarios being defined for an average risk profile:
    - Firstly, this statement applies to all risks and all undertakings, including those who don't utilise MLR. The RAB does not agree that MLR and those who utilise it should face additional regulation.
    - The consultation fails to note Solvency II has established safeguards in place, as noted in the 2021 Opinion, Paragraph 13: *"Risk mitigation techniques are a key element of the undertaking strategy and risk management system. Therefore, the appropriateness of the Standard Formula should be valid considering all reinsurance arrangements in place and should be assessed in the own risk and solvency assessment (ORSA)"*.
- Finally, Paragraph 3.45 expects an assessment of the effective risk transfer on the basis of a single component of the RMT, ie the attachment point, rather than the RMT in its entirety. This is disproportionate and goes beyond the 2021 Opinion and the binding regulation.

Q13.2. *Section 3.3.8.1: Measurement period and renewals.*

Paragraphs 3.46 to 3.49

The RAB disagrees with Paragraph 3.49 and recommends it is deleted:

- The clause considered in this section (described as a "high water mark") defines the ongoing coverage of the MLR after the reinsurer has paid a claim. For the reasons outlined in detail in Q2.1, the RAB strongly believes events beyond the one-year time horizon should be out of scope of any guidance.

Q14.2. *Section 3.3.8.2: Liquidity risk.*

Paragraph 3.50

Please refer to the response to Q14.1.

Section 3.3.8.3. Multi-year mass-lapse events

Comments should be provided in the "Question to stakeholders 2".

Q15.1. *Section 3.3.9: Early termination clauses*

Comments to the blue box

The RAB recommends clarifying that this guidance targets a specific and narrow scope.

- Early termination clauses usually allow reinsurers and cedants to benefit from the same clauses. They ensure a balance of contractual rights and obligations in specific pre-agreed situations. A cedent may for example be able to terminate a mass-lapse reinsurance contract early if it decides to discontinue the reinsured line of business.
- The RAB understands that EIOPA targets "early terminations" that are not either (i) those clauses that allow for both parties of an MLR to mutually agree to bring an agreement to an end or (ii) those clauses that allow the cedant to avoid entering a final year of a fixed term agreement. As such, the RAB understands the consultation is not describing the current market practice and is not proposing a change to such practice.
- The RAB understands, on the contrary, that EIOPA focuses here on a specific early termination clause that would be only available to the reinsurer to terminate the contract at will (ie without the occurrence of specific events or the triggering of conditions) and at short notice. Therefore, we would suggest clarifying the text in the blue box as follows: "Where the contractual arrangement provides solely to the reinsurer the option to unilaterally terminate the contract early without any prior conditions, the residual measurement period and the residual duration of the treaty should be sufficient to ensure an effective risk transfer."
- The RAB notes that the use of the terms "residual duration" and "residual measurement period" is somewhat confusing since both would have an equal time period based on Footnote 17.

Q15.2. *Section 3.3.9: Early termination clauses*

Paragraph 3.51

Please refer to the comments above.

Q15.3. *Section 3.3.9: Early termination clauses*

Example early termination

- As explained in our response to the section on attachment point, the statement *"The attachment point is equal to 1-in-30-year event, e.g., 15%"* is not needed nor appropriate.
- The RAB notes that an early termination of a 36-month contract with 33-month notice should not be considered as a realistic example.

Q16.1. *Section 3.3.10: Special termination clauses.*

Comments to the blue box

The RAB recommends that EIOPA removes Section 3.3.10 entirely to ensure the continuity of legitimate risk management practices and the proper functioning of the mass-lapse reinsurance market. Potential concerns on termination clauses are addressed more generally in Section 4 of the Annex.

- There is no sound risk-based justification nor legal basis to require treaties to stipulate that termination should not apply before the end of the measurement period.
- Special termination clauses are in favour of both parties and they serve a legitimate risk management purpose by ensuring the sustainability of the contract and safeguarding the interests of both parties against unforeseen circumstances, ultimately contributing to the contract's stability and risk-sharing effectiveness.
- A reinsurance contract establishes continuing obligations between the parties, it can be terminated immediately by either party for good reasons under special circumstances without having to observe a longer notice period. Good reasons exist if there are facts which, taking into account all circumstances and weighing up the mutual interests, make it unreasonable for the terminating party to continue the contractual relationship (eg if the cedent ceases to hold an insurance license to operate). In many jurisdictions, this right to extraordinary termination cannot be excluded by contractual language.
- The RAB considers this section to be detrimental to sound and legitimate risk management practices for both parties. We urge EIOPA to remove Section 3.3.10. Termination clauses are addressed more generally in Section 4, thus limiting the impact of this removal. Please refer to response to Q16.2 for further explanation.

Q16.2. *Section 3.3.10: Special termination clauses*.

Paragraphs 3.52 to 3.55

- The RAB considers special termination as very unlikely to occur given the events specified to trigger the clause and only following something material such as a cedant misrepresenting something or failing to pay the reinsurance premium. In such a situation it is unreasonable to expect the reinsurer to remain on a risk for 12 months and pay a reinsurance claim.
- Special termination rights provide safety for reinsurers with regards to the consequences of extraordinary severe events or breaches while also protecting cedants from being tied to a reinsurer unable to meet its obligations. The purpose of the termination clause is aligning interests of the insurer and (re)insurer, minimising the risk of anti-selective behaviour, and ensuring minimum service standards (eg cedents' obligation of full disclosure to the reinsurer of all information and data that are material to the risks being assumed by the reinsurer). They ensure the sustainability of the contract and safeguard the interests of both parties against unforeseen circumstances, ultimately contributing to the contract's stability and risk-sharing effectiveness.
- In practice, special termination clauses give an option to terminate but not an obligation. They can serve as a trigger for renegotiation of the calibration of the treaty in line with the original intent of the parties. This is a lever to ensure that the treaty stays fit-for-purpose over time. For example, special termination in case of material changes in regulation and/or applicable laws are particularly important to trigger the review of the treaty terms and find a solution which preserves the parties' original commercial intention and economic effect in relation to this treaty in the new regulatory environment.
- The list of examples in Paragraph 3.52 is not indicative of clauses creating material basis risk with the meaning of Article 2010(3). For example, regarding the termination clause for an insolvency event, EIOPA could note the insolvency event clause would be triggered by the liquidation of the cedent on a gone-concern basis whereas Article 101(2) of the Solvency II Directive sets out that "The Solvency Capital Requirement shall be calculated on the presumption that the undertaking will pursue its business as a going concern". Therefore, the credit for reinsurance within the standard formula cannot be challenged by the existence of a clause to be applied outside of the scope of the standard formula.
- In conclusion, there is no sound risk-based justification nor legal basis to require treaties to stipulate that termination should not apply before the end of the measurement period when there is a legitimate risk management purpose. It is recommended that EIOPA removes Section 3.3.10 entirely.

Q16.3. *Section 3.3.10: Special termination clauses.*

Example special termination clause

- Our comments on the similar example under Early Termination Clauses (Q15.3) apply.
- Please refer to Q16.1 and Q16.2 for our comments on the principles used to define this example.

Q17.1. *Section 3.3.11: Estimating the risk-mitigating effect*

Comments to the blue box

- The RAB agrees with this statement. The RAB would recommend keeping Section 3.3.11, adding that when analysing the RMT effect, particular attention should be paid to certain elements highlighted elsewhere in the paper such as fixing parameters, cliff edge effect or high watermark. All those sections which are prescriptive, disproportionate and otherwise inappropriate should be removed.

Section 3.4: Reinsurer's perspective

Q18.1. *Section 3.4: Reinsurer's perspective*.

Comments to the blue box

- The RAB agrees with the statement.

Q18.2. *Section 3.4: Reinsurer's perspective.*

Paragraphs 3.56 to 3.57

- The RAB agrees with the statement.

Section 3.5: Balance Sheet

Q19.1. *Section 3.5: Balance Sheet.*

Comments to the blue box

- The RAB agrees with the statement.

Q19.2. *Section 3.5: Balance Sheet.*

Paragraphs 3.58 to 3.65

- Paragraph 3.62 notes MLR as a *"niche market when compared to other reinsurance treaties"* without discussing its considerations for reaching this conclusion. While it does not appear to be a key aspect of the consultation, the RAB would note that, in contrast to a truly niche market, there are a significant number of MLR treaties in place, in many Member States, and a number of active reinsurers. In addition, EIOPA has put significant work into this consultation which would put MLR as the first Annex to its 2021 Opinion which would again suggest that a more-than-niche market exists.

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Section 4: Reinsurance agreements' termination clauses

General comments

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

- As a preliminary remark, EIOPA should add a comment making clearer that this section (similar to the rest of the paper), only applies to standard formula users, recognising internal model users' capacity to model specific treaty features where appropriate and as provided for in Article 235 of the Solvency II Delegated Act.
- EIOPA should acknowledge that, in general, termination rights in reinsurance arrangements provide safety for reinsurers with regards to the consequences of extraordinary severe events or breaches while also protecting cedants from being tied to a reinsurer unable to meet its obligations. The purpose of the termination clause is aligning interests of the insurer and (re)insurer while minimising the risk of anti-selective behaviour, eg service standards or a cedents' obligation of full disclosure to the reinsurer of all information and data that are material to the risks being assumed by the reinsurer. They ensure the sustainability of the contract and safeguard the interests of both parties against unforeseen circumstances, ultimately contributing to the contract's stability and risk-sharing effectiveness.
- The RAB agrees that the use of termination clauses in reinsurance contracts should target specific purposes like the elimination of moral hazard as mentioned above, ensuring that they do not materially undermine risk transfer in the normal run of events. However, the RAB is concerned about the potential scope of this section. The RAB understands that EIOPA wants to set guidance on specific and rare termination clauses where the reinsurer is released of its obligation to pay "legitimate" claims upon the occurrence of predefined events. Because this concept of "legitimate claims" can be misinterpreted or misconstrued, the RAB urges EIOPA to add in Paragraph 4.2, 4.3, 4.8 and 4.9 the following clarification:

  > *"However, termination clauses that stipulate that premiums, claims, expenses and fees (as applicable) related to the period prior the occurrence of the event are to be settled at the point of the event, per the reinsurance arrangements, are considered to be in line with the conditions in the delegated regulation regarding the effective transfer of risk."*

- While EIOPA's proposed restrictions on termination clauses aim to ensure the effective transfer of risk, the RAB notes that overly strict limitations are not needed and could conflict with standard business practices that have been established over decades to ensure contractual balance and fairness between the parties. Termination clauses help to address unforeseen circumstances and ensure contract stability. For instance, clauses allowing termination under certain conditions, like material breaches of obligations by one of the parties or changes in regulatory circumstances, are vital for managing operational and credit risks. EIOPA should acknowledge that termination clauses contribute to insulate the treaty from litigation risk between the parties and to help manage their risk exposure in line with their risk appetite and system of limits.
- The RAB does not agree that termination clauses for insolvency events may compromise the "effective transfer of risk for the purposes of the SCR calculation". The effective transfer of risk should be assessed on a going concern basis for the SCR calculation. Credit for reinsurance should be recognised in the SCR when risks are transferred effectively in the scenarios of the standard formula.

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Description of the case

Q21. *Section 4.1: Description of the case*.

Paragraphs 4.1 to 4.4

- **EIOPA should remove in Paragraph 4.3 the reference to "insolvency".** Insolvency event termination clauses are standard market practices which are usually bilateral, ie both the reinsurer and the cedent benefit from one. The existence of an insolvency event clause in treaties does not bar them to effectively transfer risks on a going concern basis, as per Article 101(2) of the Solvency II Directive.
- EIOPA mentions that the "the contractual arrangements and transfer of risk [must be] legally effective and enforceable in all relevant jurisdictions" (Article 209 (1.a), ie that the arrangement is not "subject to any condition which could undermine the effective transfer of risk, the fulfilment of which is outside the direct control of the insurance or reinsurance undertaking" (Article 210 (4)). The RAB does not agree that termination clauses will compromise enforceability and the effective transfer of risk for the purpose of the SCR calculation. Legal effectivity and enforceability of a contract is distinct from the scope of the risks transferred by a contract. What matters is that the conditions of a legally effective contract are compatible with the purpose of the treaty to transfer risk in the scenarios of the standard formula.

Analysis of the case

Q22. *Section 4.2: Analysis of the case.*

Paragraphs 4.5 to 4.10

- The RAB would like EIOPA to explicitly clarify that the clauses described in Section 4.7 are considered in line with the conditions in the Delegated Regulation regarding the effective transfer of risk.

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