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Position Paper

Response to EIOPA consultation on the revision of the guidelines on contract boundaries

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Introduction

1. General comments

- Contract boundaries is a topic of great importance for the insurance market. The industry therefore welcomes the opportunity to comment on the European Insurance and Occupational Pensions Authority's (EIOPA) proposed changes to the guidelines on contract boundaries presented in this consultation.
- The industry understands that EIOPA's proposals aim to further clarify Article 18 of the Solvency II Delegated Regulation. Some of EIOPA's proposals would, however, lead to confusion and the industry would therefore welcome further clarifications — in particular on how the proposed thresholds for the evaluation of the discernible effect of a guarantee have been defined — as well as further explanations about how EIOPA and national supervisory authorities (NSAs) intend to achieve convergent practices.
- The industry is also concerned that the approach proposed by EIOPA for the quantitative determination of the discernible effect of financial guarantees will generate extensive additional operational burden. It appears that a significant part of the determination of the discernibility of the effect will be left to the discretion of supervisors.
- EIOPA's proposal that NSAs may require a quantitative assessment from the undertaking and that the result of this quantitative assessment should prevail should be removed. The proposed wording is redundant, as supervisors already have the power to request information from companies as part of the supervisory review process and it could be interpreted as introducing a de facto supervisory approval on the treatment of contract boundaries and technical provisions.

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Guidelines

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2. **Guideline 0 (NEW) - Contract Boundaries**
   - The intention for the introduction of guideline 0 is not clear.
   - The scenario discussed in para 3.3 that "*in case of a contract with a paid-in premium where either party can cancel the contract during a limited period of time"* is the situation specified in Directive Article 186 on the cancellation period, which stipulates that policyholders have between 14 and 30 days to cancel their insurance contract. Hence, it is not a specific circumstance, but relevant for all new business.
   - However, Insurance Europe takes the view that paragraph 3.3 should be removed or at least proportionality should be allowed for. Technically the statement is correct: however, in some member states the cancellation period applies to both insurer and policyholder, so the contract boundary should be capped to the end of the cancellation period. However, in practice, the cancellation period is almost never used.
     - Firstly, insurers will normally not cancel a new client and policyholders seldom cancel their contract. Insurance sales adhere to very strict standards to avoid mis-selling.
     - Secondly, new business is, for most companies, a relatively small part of their portfolio.
     - Thirdly, the cancellation period is quite short, so the cancellation period only still applies for new business up to 30 days before the reporting date. As a result, the impact of the very small number of cancellations on the technical provisions is too limited to justify setting up a model to take the cancellation period into account.
   - Paragraph 3.7, "*example 2: General account product with profit sharing features that matures after 8 years. … before the renewal date.* "and paragraph 3.8 EIOPA states that "*In this case, the undertaking should do a realistic projection of future cash flows, … underestimation of the Best Estimate.*"

     This example seems to require an assessment of the possible retention of the policyholders and to include this in the best estimate and capital requirement calculations.
   - It may also contradict Art. 18 (3), which states that only in case that the company can force the policyholder to pay the future premium, is the premium within the contract boundary. However, the example seems to imply that renewal premiums after 8 years and corresponding obligations are within the contract boundaries, while after 8 years the policyholder and company have a unilateral right to cancel the contract. This means that the company cannot force the policyholder to pay premiums after year 8. In light of this, EIOPA is asked whether this example allows the consideration of additional premiums after the original maturity of 8 years based on realistic renewal assumptions.

3. **Guideline 5 (AMENDED) - Unbundling of the contract**
   - In paragraph 3.11 EIOPA states that "*Therefore, any contract that is equivalent in terms of risk to two (or more) parts of the contract could be sold independently should be unbundled. To assess such equivalence only insurance and financial risk should be considered and non-discernible differences should not prevent the contract from being unbundled.*".
     - It should be noted that insurance and financial risks cover most of the risks that the entity is facing.
     - The question of the discernibility of the differences in the economics of the contract of the different parts is not specified, and is therefore left to the discretion of NSAs. In that regard, the objective of supervisory convergence wouldn't be achieved.

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

   - Insurance Europe is concerned that the proposed Guideline 6a would lead to significant additional operational complexity in the evaluation of the discernibility of the effect on the economics of the contracts.

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- The following text should be removed from paragraph 2.9. "*However, supervisory authorities may require a quantitative assessment … assessment should prevail*." The wording is redundant, as NSAs already have the power to request information as part of the supervisory review process. The wording could be interpreted as introducing a de facto supervisory approval on the treatment of contract boundaries and technical provisions, and this is not appropriate given that the Solvency II regulation is already in place. In any case, if a qualitative analysis is carried out, it should be considered in the same terms.
- For a quantitative assessment, Insurance Europe's understanding is that undertakings will have to project all relevant cashflows when calculating the expected present value, then decide, whether or not to include those cashflows in the best estimates, while also taking into account Article 18.3. This automatic calculation will require insurers to make structural assumptions on future cash flows and to undergo significant model developments.
- The guideline also implies that the assessment is to be performed at the inception of the contract. However, further clarity is needed on to what extent new business will be allowed to be compared to in force contracts for which a discernible assessment has already been performed, and to what extent this assessment can be applied to new contracts.
- The industry would also like to raise concerns about the comparison of two contracts presenting similar guarantees while being issued at different moments in time. The provided guidelines should clarify in what conditions two distinct assessments will need to be performed or to what extent contracts can be deemed comparable without having to reassess the discernable effect. It is Insurance Europe's understanding that, without further guidance, this interpretation will be left to NSAs.
- Given the lack of clarity on the calculation of the expected present value and of the discernible effect, a significant share of the appreciation of the discernibility will be left to NSAs.

Additional comments

- The industry opposes the introduction of thresholds such as those proposed in paragraph 3.18. More information on the derivation and appropriateness of these thresholds should be provided. The range appears to be very sensitive and doesn't appear appropriate for all kinds of context and/or jurisdiction.
- "*The quantitative assessment should be based…on an expected present value basis is discernible*". For example, an assessment could be based on an average basis: ie expected value or on scenarios where financial guarantees become in the money, ie potential cash flows.
- In paragraph 3.20 "*For the purpose of this assessment, future discretionary benefits whose allocation is absolutely voluntary for the undertaking, the expected payments should not be considered…*", EIOPA should provide more background as to whether future discretionary benefits other than those that are absolutely voluntary shall be taken into account for the assessment of discernible effect.

- Guidelines should clarify that all references to the need to assess discernible effects, for the purposes of whether premiums/obligations belong to the contract or not, only refer to **future premiums** (Article 18(5)). "Future premiums" should be clarified: Insurance Europe takes the view that it should be payments effectively made by the policyholder. Other charges, such as those deducted from the provision should not be considered as future premiums, as they are part of the benefit where the policyholder has no capacity to act on them as they are implicit in the agreed benefit (such as a lower benefit or lower profitability).
  - For example, a whole life unit-linked product with a single premium paid at the beginning of the contract, that periodically deducts costs from the market value of the fund, should not require an assessment of financial guarantees or technical hedges. In this case, when calculating technical provisions, surcharges charged to customers are expected to be projected, whilst the debate is around periodic premiums.
  - Therefore, paragraphs 3.14 and 3.21 should be amended as follows: *"[…] represents only a small percentage of the* ***premium paid by the policyholder*** *~~annual investment management fees charged to the policyholder~~"*

5. **Guideline 6b (NEW) - Identification of a coverage for a specified uncertain event that adversely affects the insured person with a discernible effect on the economics of a contract**
   - The approach proposed by EIOPA seems contradictory to Article 18, which states that, regardless of the positive or negative effect, any discernible impact of a coverage of events on the economy of the contract must be taken into account. EIOPA's approach seems to consider that only coverage of events having a detrimental discernible impact on the economy of the contract should be taken into account.
   - The following text should be removed from paragraph 2.14. "*However, supervisory authorities may require a quantitative assessment from the undertaking and the result of this quantitative assessment should prevail.*" The proposed wording is not necessary, as supervisors already have powers to request information from companies as part of the supervisory review process. The wording could be interpreted as introducing a de facto supervisory approval on the treatment of contract boundaries and technical provisions. As well as not being appropriate having regard to the Solvency II regulation already in place on the calculation and governance of Solvency II technical provisions, it is fundamentally inappropriate to introduce what can be interpreted as a form of supervisory approval of technical provisions in an uncertain manner and through guidelines in this way. This will not provide for consistency of approaches.
   - In addition, the approach proposed by EIOPA based on the expected present value is complex and may inadequately reflect insurance risk. A simpler, more consistent indicator would be the sum insured at risk at the time of the valuation, which is a good indicator of the risk coverage of the product.

     Therefore, the industry proposes to amend the last paragraph of the guideline in this way:

     […] The quantitative assessment should be based on whether the proportion of the sum assured of the cover over the technical provision ~~relative difference in the value~~ of all future obligations related to the contract ~~with and without the cover ("value of the cover") on an expected present value basis~~ is discernible […]

6. **Guideline 6c (NEW) - Reassessment of the discernible effect of a cover or financial guarantee**
   - The industry asks EIOPA to provide further background on "*the necessity to perform a reassessment of the discernible effect if there is an indication that it may lead to a different conclusion*".
   - Against this backdrop, and given the lack of clarity on the conditions leading to the reassessment of the discernability of the effect of a cover or a guarantee, the industry takes the view that the decision on the need to reassess will be left to NSAs.

Explanatory text

9. **Explanatory text on Guideline 6b (NEW) - Identification of a coverage for a specified uncertain event that adversely affects the insured person with a discernible effect on the economics of a contract**
   - In regards to the proposed thresholds for the evaluation of the discernible effect of a guarantee, EIOPA should explain how the proposed thresholds have been defined. The proposed range for the threshold appears to be very sensitive to the economic context and doesn't appear appropriate for all kinds of context and/or jurisdiction. The industry opposes the introduction of thresholds and would welcome further rationale on how the proposed thresholds are deemed appropriate.

Insurance Europe is the European insurance and reinsurance federation. Through its 37 member bodies — the national insurance associations — it represents all types and sizes of insurance and reinsurance undertakings. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers pay out almost €1 000bn annually — or €2.7bn a day — in claims, directly employ nearly 950 000 people and invest over €10.4trn in the economy.