

**Pre-Consultation
on
Draft Implementing
Technical Standard
on
Contract Boundaries**

Draft Technical Standard

In order to promote an effective application of the regulation relative to the Contract Boundaries, the following definition shall be applied:

DEFINITIONS

TS 0 (level 2 Article 13 TP2): Definitions

For the purpose of these [Implementing Technical Standards] the following definitions shall apply:

1. 'Obligations that relate to paid premiums' means the obligations recognized by the insurance or reinsurance undertaking in accordance with Article 12 TP1 of the Level 2 delegated act, that are attributable to the paid premiums in accordance with the provisions set out in Article 252(2) to (5) of the Level 2 delegated act.

2. An 'individual risk assessment' means any assessment of relevant features of the insured person allowing the insurance undertaking to gather sufficient information in order to get an appropriate understanding of the risks associated with the insured person.

In the case of contracts with mortality risks or health SLT guarantees, an individual risk assessment shall consist of a self-assessment of the insured person or shall include a medical examination or survey.

3. A 'portfolio of obligations' means for the purposes of Article 13 of Level 2 delegated act a set of obligations whose premiums and benefits can be amended in a similar way.

ET: Portfolio of obligations are not necessarily composed of obligations with similar characteristics.

Technical Standard 1 (level 2 Article 12 TP1): uniqueness of the boundary of a contract

For each contract, or where unbundling applies in accordance with TS5, for each unbundled part of the contract, the undertaking shall identify a unique set of potential future premiums and obligations falling into the boundary of the contract or into the part of the contract, thereby determining a unique contract boundary or unique unbundled part contract boundary.

The undertaking shall establish the boundaries of a contract, or of their parts, at the time the contract is recognised in accordance with Article 12 of [Level 2 delegated act].

The undertaking shall not change the boundary of a contract, or of an unbundled part of the contract, during its lifetime, unless explicitly set out in these Implementing Technical Standards or in case of steep and persistent changes in the financial markets. The undertakings shall not change the boundary of a contract in case of changes in financial markets which scale do not significantly exceed the scale of the changes usually seen during the economic cycles.

ET : The payment of the potential premiums which are in the contract boundary may be conditioned to event or to the value of sets of financial or non-financial variables. Therefore, a premium does not need to be certain to be included in the contract boundary.

For example, in the case of a premium which meets all the conditions to be included in the contract boundary and is conditioned to an event X, the premium is in boundary of the contract, the issue of the weighing of the probability of X being relevant for valuation purposes but not for the determination of the boundary of the contract.

UNDERSTANDING OF VARIOUS TERMS

Technical Standard 2 (level 2 Article 13 TP2): understanding of the unilateral right

The insurance or reinsurance undertaking shall consider the right as defined in Article 13 TP2 (1) to be unilateral, when neither the policyholder nor any third party can impede the use of that right. In particular:

- a) Where the unilateral right is conditioned to events or external opinions, the existence of such conditions limits the unilateral right if, and only if, those conditions give the policy holder or any third party the right to impede the use of that right.
- b) Undertakings shall not consider competitive pressures as limitations of the unilateral right.
- c) Limitations contained in national laws limit the unilateral right if and only if those conditions impede, or give the policyholder or a third party the right to impede, the use of that right.

- d) If insurance or reinsurance undertaking has the ability to terminate the contract with defined notice, it shall be considered as unilateral right to terminate the contract regardless of profitability of such termination.
- e) Insurance or reinsurance undertaking is not the holder of the right to amend premiums or benefits if the premium or benefit fluctuation depends solely on the decisions of the policyholder or the beneficiary.

ET:

Some premium or benefit changes agreed upon at inception of the contract which depend on factors beyond the control of the undertaking (e.g. inflation, increase of salary). Such a change should not be considered an amendment in terms of contract boundaries provided that the same premium structure as agreed at the inception of the policy is used. E.g. lapses of such policies should be considered as being policy holder behaviour in accordance with article 21 TP8 (2). In the terms and conditions of the policy it is often agreed on certain payment or benefit plan. This agreement itself does not imply that the change would be amendment in terms of contract boundaries.

Example 1 (several payment plans): It has been agreed upon that at the inception of a savings contract there is a single premium equal to 10.000 euros, then the premium will be annually equal to 1000 euros. This change is not due to the insurance undertaking but due to the policy holder.

Example 2 (cost-of-living index): It has been agreed upon that at the inception of a term insurance, the death cover is 100.000 euros and both the premium and the cover are linked to cost-of-living index. This change is not due to the insurance undertaking but due to an external measure.

Example 3 (defined benefit plan): It has been agreed upon a defined benefit group pension scheme. The pension is defined to be 60 % of the salary. The target pension fluctuates in accordance with the fluctuation of the salary. This change is not due to the insurance undertaking but due to the policy-holder.

In unit linked insurance it is the policyholder or the beneficiary that define how the accrued savings are allocated.

Example 4 (unit linked): The policy holder invests each month 200 euros into a unit linked product. The loading is 2 %. So, the unit linked accounts are accrued by 196 euros each month. The basis of expenses and the risk premiums do not change from time to time. However, the savings in euros change, but the change does not depend on the fluctuation of the risk or the decisions of the insurance undertaking.

Technical Standard 3 (level 2 Article 13 TP2): understanding of the ability to compel

The undertaking shall recognize an ability to compel a policyholder to pay a premium if and only if it is legally enforceable.

ET: For any premium payment foreseen in the contract but which would not be legally effective and enforceable in the relevant jurisdiction, it cannot be considered that the undertaking has the ability to compel the policyholder to pay it. For instance, the holding by the insurance undertaking of the Bank Identifier Code of policyholders shall not be characterized as a means for insurers to compel policyholders to pay the premiums in particular for contracts with scheduled future premiums.

Technical Standard 4 (level 2 Article 13 TP2): understanding of full reflection of the risk

1. Insurance or reinsurance undertakings shall carry out the assessment referred to in Article 13(2bis) by a comparison of the following items:
 - a) On the one hand, the present value of the premiums payable under the portfolio from the moment when either premiums or benefits are amended.
 - b) On the other hand, the present value of the benefits and expenses payable under the portfolio that relate to the premiums payable under the portfolio from the moment when either premiums or benefits are amended.

All amounts shall be assessed taking into account the current assumptions used to calculate the best estimate.

2. The scenario mentioned in Article 13(2bis) refers to any possible situation or circumstance that the insurance or reinsurance undertaking might face at the moment of amending the premiums or benefits which results in a limitation of the undertaking's unilateral right to amend the premiums or benefits in such a way that the premiums of the portfolio fully reflect the risks covered by the portfolio.
3. Where an undertaking has voluntarily applied discounts in form of either reductions of premiums or increase of benefits in such a manner the risk is not fully reflected in the premiums of the contract, the undertaking shall carry out the assessment of Article 13(2bis) adding the discounts to the premiums in such a manner that the voluntary accepted discounts do not act to any extent as limitations in the capacity to fully reflect the risk.

ET :

In practice almost all premiums change from time to time and the nature of the change should be considered. Consideration if a change is an amendment in terms of contract boundaries should be made portfolio by portfolio.

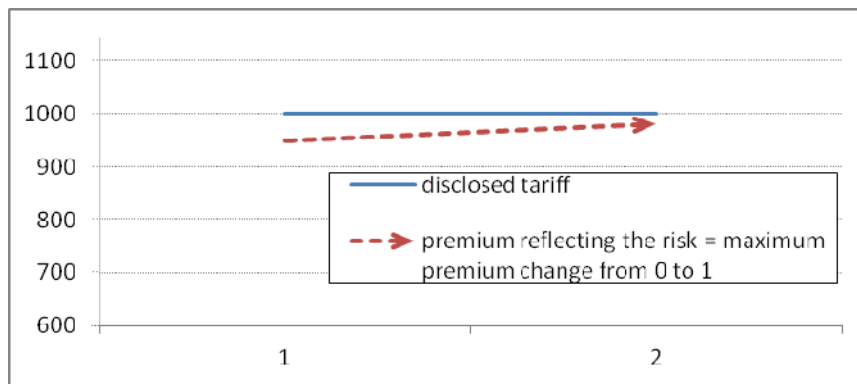
Premium decreases and benefit increases are not considered to be amendments in terms of contract boundaries but given discretionary benefits or other management actions.

In contract law the disclosed terms and conditions are binding. The same applies the disclosed premium. Regarding the discounted premium, this means that if the

policyholder is not aware of the maximum amount of the amendment and the right of the amendment, the insurance undertaking may not amend the premium or benefit. In the examples below it has been assumed that the binding terms have been disclosed already during the offer phase. The policyholder has to be aware of the terms and conditions. So, it is relevant from the policy holder point of view if he knows of the possibility to amend the benefits.

Example : *The premium from which the discount has been counted is 1000 euros (e.g. mortality reference applied by the insurance industry) but the premium reflecting the risk at the inception of the agreement is 950 euros. The risk increases to 980 euros.*

In the offer as well the reference premium 1000 euros and the 50 euro discount have been mentioned and the right to amend premiums to reflect the risk. Because 1000 euros does not reflect the risk of the portfolio at the inception of the contract, the premium may be increased only up to 980 euros within the contract boundaries.



UNBUNDLING

TS 5 (level 2 Article 13 TP2): Unbundling of the contract

1. Insurance or reinsurance undertakings shall unbundle a contract for the purpose of article 13 TP 2 when, whether on the day at which the valuation is made or at a future date, two or more parts are clearly identifiable, for which it is possible to define in an objective manner the different set of obligations and premiums attributable to each part.
2. The set of obligations attributed to a part of the contract can be constituted by obligations of various types, including obligations expressed as financial option or guarantees which can be automatically triggered or at the hand of the policyholder or of any other party.

The undertaking shall unbundle any contract which can be unbundled into two or more sets of obligations in such a manner that the obligations of each set are separately communicated to the policyholder.

The undertaking shall consider two sets of obligations as communicated separately where the meaning of each is maintained in the case the mention of the other sets of obligations were to be removed.

3. The undertaking shall unbundle any contract which can be unbundled into two or more sets of obligations in such a manner that the premiums of one part are separately paid by the policyholder.
4. When an option or guarantee covers more than one part of the contract, the undertaking shall unbundle it or shall attribute it to one of the part of the contract if relevant.

***ET:** In case of contracts with both unit-linked obligations (and their related options and guarantees if any) and profit-sharing obligations (and their related options and guarantees if any), the contract should be unbundled between each unit-linked part with its related options and guarantees and each profit-sharing part with its related options and guarantees*

Technical Standard 6 (level 2 Article 13 TP2): placeholder for potential additional TS on unbundling

DISCERNIBLE EFFECT

Technical Standard 7 (level 2 Article 13 TP2): identification of a discernible effect on the economics of a contract

The insurance or reinsurance undertaking, when determining whether the coverage of an event or a financial guarantee has a discernible effect on the economics of a contract, shall take into account all potential future cash-flows which may arise from the contract.

ET : If the coverage of an event or a financial guarantee has a discernible effect on the economics of the contract (as defined in TS10) then the cash-flows arising from the event or financial guarantee need to be considered for the purposes of establishing the contract boundary.

TS 8 (level 2 Article 13 TP2): Discernible effect of financial guarantees

Insurance or reinsurance undertakings shall consider a financial guarantee of benefits as having a discernible effect on the economics of a contract if and only if paying the future premiums to which this financial guarantee is applicable provide the policyholder with a discernible financial advantage under at least one scenario with commercial substance, that the policyholder or insured would not have received without paying the new premiums.

ET:

A guarantee that a policy-holder does not lose at least part of its savings shall be considered as a financial guarantee, which may or may not have a discernible effect on the economics of the contract.

TS 9 (level 2 Article 13 TP2): Discernible effect of the coverage of an event

Insurance or reinsurance undertakings shall consider the cover of a specified uncertain event that adversely affects the insured person as having a discernible effect on the economics of the contracts when the cover provides a discernible financial advantage to the beneficiary.

MISCELLANEOUS

Technical Standard 10 (level 2 Article 13 TP2): Policy holder's options for additional cover

Insurance or reinsurance undertakings shall consider that a policy holder's option for additional cover is in the boundary of the contract where the price of the add-on or its basis are specified in the contract and the criteria set out in Article 13(1)(a) are met in respect of the add-on.

Technical Standard 11 (level 2 Article 12 TP1): recognition of obligations – special cases

Insurance or reinsurance undertakings shall, in case details of contracts or the full obligations covered by contracts are not available to the undertaking at the time of the recognition of the contract, estimate the boundaries of the contracts using the available information in a manner consistent with the principles set out in these Implementing Technical Standard.

The undertaking shall revise this assessment when more detailed information is available.

ET:

This situation can arise, where there is a delegated underwriting authority or binder which can sign business on behalf of the undertaking and there is a delay in receiving information from the authority. Estimates of contracts entered into can be based on historical experience of specific binders in terms of numbers of contracts likely to be entered into and their terms and conditions and hence the length of their contract boundaries and likely corresponding cash-flows.

The undertaking should aim to minimise the delay to receive detailed information from the binder and should make a revised assessment of the contracts entered into and their

corresponding contract boundaries as soon as is reasonable, to perform this analysis, after this information has been received.

In the situation that updated exposure information becomes available after the contract has been signed (e.g. because the underlying exposure changes in the case of some liability contracts or underlying exposure is unknown at the time of signing for contracts covering voyages undertaken in a certain time period) we would not expect this to lead to a change in the contract boundary. If however this analysis leads to a change in contract boundary, the contract boundary should be updated where the change is material.

Technical Standard 12 (level 2 Article 13 TP2): Boundary of the contracts of a reinsurer

The insurance and reinsurance undertakings shall, for their accepted reinsurance contracts, apply provisions of the article 13 TP 2 of the Level 2 delegated act without taking into account the boundary of the underlying insurance or reinsurance contracts to which they relate.

ET: The boundary of a reinsurance contract may be different in the Solvency II balance-sheet of the buyer of the reinsurance when compared to the Solvency II balance-sheet of the seller of the reinsurance.