

To: Solvency II WG
 From: Prudential Team
 cc:
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Subject: Technical Provisions - Assessment of EIOPA's final report on the revision of the TP guidelines

Summary

- The secretariat has prepared an assessment of EIOPA's revision of the guidelines on technical provision.
- Relevant documents:
 - EIOPA's Resolution of Comments from the Public Consultation of guidelines on technical provisions ([here](#))
 - EIOPA's Final Report on the public consultation on the revision of the Guidelines on Technical Provisions ([here](#))
 - Insurance Europe response to EIOPA consultation on the revision of the guidelines on technical provisions. ([here](#))
- A number of Insurance Europe's concerns have been addressed, in particular regarding proportionality.
- EIOPA considers that implementation should be possible by the 1st of January 2023 in almost all cases. However, EIOPA acknowledges that this can be a challenge for IFRS 17 users. In these specific cases, NSAs may decide to follow a flexible approach for the first application of these Guidelines.

Assessment of EIOPA's final report

Topic	IE consultation Response	EIOPA's final report
General comments	The consultation paper suggests that EIOPA already intends to apply the revised guidelines in 2022 and that currently no transitional phase is foreseen. For undertakings that have not already implemented the details of the revised guidelines, a sufficient transitional period, eg at least three years , is required. As all relevant resources are currently bound to the implementation of IFRS17 an even a longer transitional period would be welcomed.	EIOPA considers that implementation should be possible by the 1st of January 2023 in almost all cases. However, EIOPA acknowledges that this can be a challenge in the specific cases of IFRS 17 users that are also significantly impacted by these Guidelines. In these specific cases, national competent authorities may decide to follow a flexible approach for the first application of these Guidelines.
	Proposals increase the granularity of the calculations required . And, although they all aim to improve the calculation results via labour-intensive fine-tuning, the effective enhancement is expected to be very limited in practice. At the same time, the burden of proof for non-materiality of the amendments is solely	The analysis performed by EIOPA during the 2020 review shows that the current practices diverge across Europe, therefore endangering the level playing field. EIOPA considers that most of these divergent practices usually arise from a lack of detailed guidance regarding some elements of best estimate valuation in SII. Now both EIOPA and its

	<p>on insurance undertakings. Before introducing such amendments, a sufficient demonstration that the impact is material should be conducted.</p>	<p>stakeholders have more experience and a better understanding of SII, so it is the right moment to provide more granular guidance to address these divergent practices.</p>
	<p>Proportionality should be explicitly referenced throughout the guidelines.</p>	<p>EIOPA recognizes that a proportionate approach to all guidelines on the valuation of technical provision should be applied. For this reason, EIOPA has added a Guideline 0 on proportionality and some specific considerations for particularly relevant cases as expert judgement. This will also ensure that this revision achieves the right balance between convergence and burden for undertakings.</p>
	<p>Some proposals could even force undertakings to apply unrealistic management actions which would result in distorted results: for example, guideline 40b on the consideration of new business in setting future management actions.</p>	<p>Please also note that Guideline 40b has been misinterpreted by some stakeholders and the wording has been amended, as the purpose of Guideline 40b is precisely to avoid unrealistic future management actions.</p>
	<p>It should be verified beforehand that a close causal relation can be captured in figures at all. Indeed, the amended guidelines imply that it is up to expert judgment to estimate missing data, even though there might not always be sufficient data to prove a causal link. It is difficult to rebut assumed relations in such a case, especially as policyholders cannot be assumed to always act rationally.</p>	<p>EIOPA agrees that policyholders cannot be assumed to always act rationally. However, EIOPA also want to highlight that according to article 26.a of the Delegated Regulation the lack of data alone cannot be considered to be "empirical evidence" to conclude that policyholder do not act rationally.</p>
<p>Guideline 24a (NEW) - Materiality in assumptions setting</p>	<p>The internal model guidelines in respect of expert judgement, on which the proposed guidelines (24a to 24e) are based, are in the context of insurers setting their capital requirements in extreme scenarios. Proportionality should be recognised in any new requirements for expert judgements, by reducing the extent of work and documentation, and it should not be assumed that internal model expert judgement requirements are appropriate across the board for all companies/expert judgements.</p>	<p>EIOPA agrees with stakeholders that proportionality on the application of expert judgement Guidelines will be more frequent Best Estimate valuation purposes that within Internal Model context. EIOPA considers that the new Guideline 0 and the amendments to the Explanatory Text on the guidelines on expert judgement properly address this point and will allow a proportionate application.</p>
<p>Guideline 25 (AMENDED) - Modelling biometric risk factors</p>	<p>In most cases there is no evidence that mortality, longevity and disability are correlated with economic factors. The requirement of independency implies an unnecessary burden. The proof that biometric risks are independent of any other variable should not be required</p>	<p>The amendment on Guideline 25 is only a formal amendment deleting the referent to expert judgement Guidelines as a consequence of including them within the Guidelines on valuation of technical provisions. This amendment is not introducing any new element compared to the existing Guidelines.</p>
<p>Guideline 28a (NEW) - Investment management expenses</p>	<p>It is proposed that IM should be taken into account in the TP calculation in respect of TP and the SCR. The SCR and the risk margin (RM) should not be included, as only the assets backing the best estimate (BE) are relevant here, as per policy option 3.4. Including RM and SCR in the calculation of the BE</p>	<p>EIOPA agrees with some of the arguments provided by the stakeholders and has revised the proposal focusing on the characteristics of the product, the relevant legal requirements and expert judgement instead of directly linking the investment management expenses to any specific amount in the Solvency II calculation.</p>

	can only be implemented approximately due to the circular reference with TP. Corresponding simplifications are necessary in any case which would have to be developed and tested.	
Guideline 33 (AMENDED) - Changes in expenses	<p>The implementation of the amendment and the implications from the corresponding explanatory text concerning inflation require a remodelling of the calculation program. Correlations between inflation and interest rates are not yet available and have to be developed first. This again will need proper time for testing and implementation.</p> <p>The interaction between expense's inflation and other policy flows should be further explained. On the other hand, the mention in the explanatory text of the use of different levels of inflation per type of expense is highly complex to implement in practice. It should either not be mentioned at all, or be mentioned in lighter or generic terms. Additionally it should be mentioned that there are expenses which may not be affected by inflation</p>	<p>It should be noted that the reference to inflation is already in the original Guideline 33 and the paragraph 3.14 of the consultation paper is almost identical to the paragraph 2.57 in Final Report on Public Consultation No. 14/036 on Guidelines on valuation of technical provisions, being the only difference the clarification that the expense inflation should be consistent with the characteristics of the policy (e.g. dependency of expenses on other cash-flow of the policy). In particular, the guidance on the correlation between inflation and interest rates already existed in the original version of the Guideline 33.</p>
Guideline 37a (NEW) - Dynamic policyholder behaviour	<p>The new guideline seems to increase the expectation of having to include dynamic policyholder behaviour or to expand the proof that dynamic policyholder behaviour is immaterial. this must be developed first. This will require additional data and a remodelling of the calculation program, as well as extensive testing.</p> <p>From the industry's perspective, it is expected that this will result in a high degree of additional effort for a limited effect. The consideration of the possible interaction between surrender level, the contract return and the return on the market will be especially burdensome to develop.</p>	<p>EIOPA wants to highlight that this Guideline is not creating any requirement but clarifying the application of an existing requirement from the Delegated Regulation. Article 26 of the DA requires undertakings to consider the circumstances that may influence policyholder behaviour and states that "The likelihood shall only be considered to be independent of the elements referred to in points (a) to (d) where there is empirical evidence to support such an assumption". Thus, this Guideline clarifies that lack of data alone cannot be considered to be "empirical evidence" to conclude that policyholder do not act rationally.</p> <p>In any case, EIOPA agrees that this Guideline, as any of the Guidelines on the valuation of Technical Provisions, should be applied considering the proportionality principle.</p>
Guideline 37c (NEW) - Option to pay additional or different premiums	<p>The modelling of contractual options that might have not been considered relevant until now, will need time for implementation and would require additional data, a remodelling of the calculation program, as well as extensive testing.</p> <p>The proof of immateriality of such a contract option would have to be expanded, as the new guideline increases the expectations regarding consideration of the contractual option.</p>	<p>EIOPA agrees that the revised Guidelines will require to adapt some processes in some cases, which however is unavoidable when different practices are harmonised.</p> <p>In GL 0 EIOPA has clarified that proportionality should be applicable to all the Guidelines on the valuation of technical provisions, instead of including individual specific materiality considerations in each Guideline.</p>

<p>Guideline 40b (NEW) - Consideration of new business in setting future management actions</p>	<p>The example in the explanatory text of paragraph 3.23 indicates that the assumptions on management actions for new investments should consider the new business assumptions. However, in the projection for best estimate calculation, only the run-off of the current existing portfolio is projected. The investment decisions in the model would, therefore, no longer be aligned to the portfolio considered. The industry does not consider this to be a reasonable requirement.</p>	<p>The aim of this Guideline is to provide more clarity on the assumption setting considering that the principle for continuity business - leading to writing new business - should be taken into account. Indeed, even if contract boundaries limit the obligations to be projected and the risk of the business falling beyond contract boundaries is not relevant for the best estimate valuation, some contractual features (such as profit-sharing mechanisms) create an interaction between business within the contract boundaries and business out of the contract boundaries. These interactions should be considered when setting the assumptions for the valuation of the obligations within contract boundaries. This interaction is usually taken for granted for other assumptions, as fixed expenses allocation, which are apportioned between current business and new business.</p>
	<p>In the case of the application of contract boundaries, it is unlikely that the premium or the option will be accepted or granted by the insurer without reflecting on the investment risks which will arise when the premium is due or the option is requested by the customer.</p> <p>In other cases, the contract boundary is applicable because there is no financial risk with discernible effect, even in extreme scenarios. Therefore, the need to pay attention — within the set of management actions — on asset allocation, bond reinvestment or profit sharing linked to premiums and options that meet contract boundary is not consistent with the features justifying the contract boundary itself.</p>	<p>The investment decisions for a particular portfolio that falls within contract boundaries should consider all relevant elements that will affect the real future decisions, which may include elements beyond that particular portfolio being considered (e.g. when profit sharing is based on a wider pool of assets). Otherwise, undertakings would be using unrealistic assumptions for the portfolio that are not expected to materialise. However, it should be noted that this does not mean that new business should be projected.</p> <p>To ensure a correct understanding, EIOPA has amended the Guidelines and Explanatory text.</p>
<p>Guideline 53a (NEW) - Use of stochastic valuation</p>	<p>The new guideline encompasses <u>all</u> products with profit-sharing and financial guarantees. As a result, the new scope will be much broader than is currently the case. Furthermore, it is noted that, as opposed to the current guideline 53, no proportionality is foreseen in the new guideline, even though dynamic lapse modelling requires a lot of work. The industry opposes the broadening the scope, and would ask that proportionality is foreseen.</p>	<p>EIOPA agrees that Guideline 53a should be read considering the proportionality. In particular, where the impact is not material undertakings may consider other simplified approaches or even following pure deterministic valuation in case of immaterial options and guarantees.</p>

	<p>Based on the explanatory text in paragraphs 3.24-3.26, it can be assumed that stochastic valuation avoids underestimation of provisions. The industry would ask for the possibility of maintaining non-stochastic criteria and models, as long as it can be demonstrated that they are more prudent.</p> <p>For example, when performing a stochastic valuation on future interest rate renewals for products with a variable rate, a margin above the guaranteed rate could be included in all scenarios according to the policy conditions. In this case, a simplified criteria in which these margins are not projected, could be more prudent.</p>	<p>EIOPA also wants to highlight that in some simple cases the time value of options and guarantees can be properly and accurately captured with closed-formula approaches. In these cases, closed-formula approaches can be used under the proportionality principle. These clarifications have been added in the explanatory text of Guideline 53a.</p>
<p>Guideline 57a (NEW) - Market risk factors needed to deliver appropriate results</p>	<p>In paragraph 2.36, the explicit requirement to consider the dependence on spread or default risk should be deleted. The requirement is already implied in the delegated acts and it is not clear why each undertaking should perform this assessment. An integration of credit/spread risk modelling in best estimate valuation is very burdensome: the economic scenario generator will have to be amended and, in addition, a proper and robust procedure for calibration would need to be implemented and the corresponding data procured.</p>	<p>EIOPA agrees that this requirement is implied in the Delegated Regulation. The purpose of Guidelines is to clarify and guide on the application of existing requirements where different interpretations may be possible, as in this case where divergent practices have been identified. The Guideline 57a has been slightly reworded to recognise that spread or default risk might not be material in several cases, while negative interest rates are expected to be relevant in almost any case.</p>
<p>Guideline 77 (AMENDED) - Assumptions used to calculate EPIFP</p>	<p>There is no requirement under Article 272, which describes the tasks of the actuarial function, for the actuarial function to validate the expected profit in future premiums (EPIFP) calculation. The wording here should be amended to reflect that "if the actuarial function validates the EPIFP, this should be done with specific reference to...".</p> <p>The amendment in paragraph 2.38 and the corresponding explanatory text assume that a certain structure of expenses is already implemented in the calculation model. Undertakings that do not differentiate between fixed and variable costs, will not be able to implement the amendment fully. They would therefore be either forced to restructure the modelling of the costs or companies would have to prove that they apply an appropriate simplification. Therefore, the pressure is increased to adapt the calculation model and to implement the structure of expenses.</p>	<p>Article 272 does not explicitly require the actuarial function to validate the calculation of EPIFP. Therefore, EIOPA considers that EPIFP validation by the actuarial function is a best practice but acknowledges that also other approaches would be compliant with Solvency II framework. In any case, the calculation is expected to be performed by staff with adequate actuarial knowledge to ensure consistency with the best estimate valuation as required by Article 260 of the Delegated Regulation and clarified by Guideline 77</p> <p>To properly and accurately project future expenses it is usually necessary to differentiate between fixed and variable expenses, in particular for long-term projections. However, in some specific cases it may not be necessary under the proportionality principle, in particular where the split would not have a material impact on the amount of the Best Estimate. In such cases, proportionality should also apply for EPIFP calculation, and it is not necessary to differentiate between fixed and variable costs</p>

	<p>Para 2.38: [Assumptions used to calculate EPIFP] The industry asks EIOPA to provide some more background on guideline 77. For example, maintaining the same management actions in the valuation of TP without RM, under the assumption that premiums expected to be received in the future are not received, could imply a change in the future returns of the underlying assets and hence the liability for future discretionary benefits and the cost of financial guarantees of business with discretionary participating features.</p>	<p>Under the assumption that expected premiums are not received, the future returns of the underlying assets are expected to change, as the amount of investments would be lower. However, undertakings are not expected to change the outcome of the future management actions, i.e. the projection of future cash flows should not change when valuating EPIFP, the calculation should be only a matter of identifying the cash flows related to future premiums and taking them out from the calculation without altering the remaining cash flows. However, EIOPA acknowledges that due to modelling restrictions undertakings may deviate from this mathematical approach under the proportionality principle provided the impact on the final amount of EPIFP is not material.</p>
<p>Explanatory text on guideline 53a (NEW) - Use of stochastic valuation</p>	<p>There may be cases where the reasoning of the explanatory text for 3.26 is not completely correct. For example, in cases where clients can surrender at market value, the rationale for client behaviour in high or low rate environments is not accurate.</p>	<p>EIOPA agrees that in such cases were the policyholder holds the risks (e.g. unit-linked products) and where there is no guarantee, there might be no need for a stochastic valuation. The explanatory text 3.26 however refers to policies with guarantees. Therefore, if the policyholder can surrender at market value in favorable conditions, and at a guaranteed amount in unfavorable conditions, a stochastic valuation might be needed.</p>
<p>Section 4.4.1. Policy issue1: Introduction of additional guidelines vs status quo</p>	<p>The mention in the explanatory text of the use of different levels of inflation per type of expense is highly complex to implement in practice, EIOPA should remain more generic/high-level in its wording or remove it.</p>	<p>Comment not addressed.</p>