

To: Solvency II WG
 From: Prudential Team
 cc:
 Date: 11-05-2022
 Reference: ECO-SLV-22-203

Subject: Contract Boundaries - Assessment of EIOPA's final report on the revision of the Contract Boundary guidelines

Summary

- The secretariat has prepared an assessment of EIOPA's revision of the guidelines on contract boundaries.
- Relevant documents:
 - EIOPA's Resolution of Comments from the Public Consultation of guidelines on contract boundaries ([here](#))
 - EIOPA's Final Report on the public consultation on the revision of the Guidelines on Contract Boundaries ([here](#))
 - Insurance Europe response to EIOPA consultation on the revision of the guidelines on contract boundaries ([here](#))
- EIOPA considers that implementation should be possible by the 1st of January 2023 in almost all cases.
- EIOPA acknowledges that the implementation 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.

Assessment of EIOPA's final report

Topic	IE consultation Response	EIOPA's final report
First application		<p>EIOPA has clarified that these revised Guidelines (GL) only add additional details compatible with the high-level guidance included in the previous version of the GL. For this reason, the first application of this GL should not automatically lead to a reassessment of the contract boundaries of all existing contracts (except for GL 5, 6a, 6b for undertakings currently following practices that clearly deviate from the guidance included in those GL).</p> <p>The information request showed that the expected impact of this revision of the Guidelines is expected to be low, so EIOPA considers that transitional measures are not needed.</p>

<p>Proportionality/ Materiality</p>		<p>EIOPA highlights that the current guidance includes materiality considerations and simplifications. Regarding the Guidance on discernible effect, the qualitative approach is expected to be the most frequent one, which also significantly limits the burden for undertakings. Finally, EIOPA has added some additional clarifications on proportionate approaches (eg relying on past quantitative assessments) that should allow to keep the burden for undertakings low.</p>
<p>Discernible effect</p>	<p>The industry is 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.</p> <p>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.</p>	<p>EIOPA wants to highlight that the example in the Explanatory Text of Guidelines 6a and 6b is not intended to be used as a threshold for the discernible effect assessment. The examples only represent the expectations from EIOPA and NCAs in terms of the order of magnitude for the outcome of the assessment. Further details have been included in the explanatory text to ensure this understanding.</p> <p><i>In particular, the quantitative approach proposed by EIOPA for the determination of the discernible effect should only be applied in case it is not possible to reach a clear outcome based on the qualitative assessment, which is expected to be the most frequent one. EIOPA has revised the wording on the quantitative assessment to avoid such interpretation.</i></p>
<p>Guideline 0 (NEW) -Contract Boundaries</p>	<ul style="list-style-type: none"> • IE stated that the intention for the introduction of guideline 0 was not clear. • The scenario discussed in para 3.3 is not a specific circumstance, but relevant for all new business. Paragraph 3.3 should be removed or at least proportionality should be allowed for • The example in paragraphs 3.7 and 3.8 seems to require an assessment of the possible retention of the policyholders and to include this in the best estimate and capital requirement calculations. 	<ul style="list-style-type: none"> • The aim of this Guideline is to clarify that the horizon of projection of cash flows from obligations that belong to the contract according to contract boundaries should not be limited by a point in time identified according to article 18. • <i>Regarding paragraph 3.3, EIOPA agrees to apply materiality considerations, which have been added to the text.</i> • <i>After all the comments received, EIOPA acknowledges that the example in 3.7 was not detailed enough to advice on a specific approach. Therefore, the example has been deleted to avoid any confusion</i>
<p>Guideline 5 (AMENDED) - Unbundling of the contract</p>	<ul style="list-style-type: none"> • On paragraph 3.11: 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 	<p>EIOPA agrees that the reference to discernibility opens the door for different interpretations, creating a handicap to achieve convergence. <i>However, not including this consideration would go against the objective pursued within the criteria set in the Guideline, as immaterial dependencies that do not have any economic relevance in terms of</i></p>

	<p>not specified, and is therefore left to the discretion of NSAs. In that regard, the objective of supervisory convergence wouldn't be achieved.</p>	<p>the risk borne by the undertaking would prevent the product from being unbundled. Eventually, this could lead to different contract boundaries from the case where the product is sold as two different contracts despite being economically equivalent. For this reason, as when identifying whether the product includes a cover or financial guarantee, discernibility to consider only the elements that are relevant for the assessment.</p>
<p>Guideline 6a (NEW) - Identification of a financial guarantee of benefits with a discernible effect on the economics of a contract</p>	<ul style="list-style-type: none"> • IE 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. • The following text should be removed from paragraph 2.9. <i>"However, supervisory authorities may require a quantitative assessment ... assessment should prevail."</i> 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, 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. 	<ul style="list-style-type: none"> • EIOPA does not consider the proposal to add a significant burden for undertakings in most of the cases. Nevertheless, the sentence highlighted has been deleted to avoid any misinterpretation of the content of the Guideline. • EIOPA agrees on IE's interpretation of the quantitative assessment: realistic assumptions should be used, so all relevant cash flows should be projected without considering article 18.3 limitations. Therefore, for the specific cases where a quantitative assessment is needed undertaking will need to make the assumptions and model development that will anyway be needed if the conclusion is that the financial guarantee has a discernible effect. • Guideline 6c has been improved to provide further clarity on the circumstances that should lead to a reassessment.
<p>Additional comments</p>	<ul style="list-style-type: none"> • The industry opposes the introduction of thresholds such as those proposed in para 3.18. The range appears very sensitive and not appropriate for all kind of context/jurisdiction. • In paragraph 3.20 EIOPA should provide more background as to whether future discretionary benefits other than those that are absolutely voluntary shall be taken into account 	<ul style="list-style-type: none"> • Only absolutely voluntary future discretionary benefits are explicitly excluded. Therefore, other obligations, including future discretionary benefits that are not absolutely voluntary, should be included. • Future charges or fees to cover investment management expenses and the related expenses belong to the contract (see Q&A 2102). The treatment of future charges from a savings product to cover a rider should be

	<p>for the assessment of discernible effect.</p> <ul style="list-style-type: none"> 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. Besides, "future premiums" should be intended only as payments effectively made by policyholders and other charges should not be considered. 	<p>considered to be equivalent to premiums in case the product has been unbundled. If unbundling is not possible, then the future charges should be considered to be part of the benefits from the contract. A clarification has been included in the Explanatory Text of the Guidelines.</p>
<p>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</p>	<ul style="list-style-type: none"> 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. "<i>However, supervisory authorities may require a quantitative assessment from the undertaking and the result of this quantitative assessment should prevail.</i>" 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. 	<ul style="list-style-type: none"> EIOPA agrees that positive or negative effects must be taken into account. EIOPA has revised the wording on the quantitative assessment to avoid any potential misunderstanding on its nature, which should never be understood as an approval of technical provisions. EIOPA wants to highlight that the quantitative assessment is only to be used in cases where a qualitative assessment does not lead to a clear conclusion. This quantitative assessment should be applicable for all products and, for these reasons, is based on Best estimate-like calculations.
<p>Guideline 6c (NEW) - Reassessment of the discernible effect of a cover or financial guarantee</p>	<ul style="list-style-type: none"> 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". 	<ul style="list-style-type: none"> EIOPA considers that the approach needs to be flexible enough to adapt to the specificities of each case, but additional clarifications have been added.