

Revised Guidelines on Contract Boundaries



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European Insurance and
Occupational Pensions Authority

Guideline 0 - Contract Boundaries (New Guideline)

1. Insurance and reinsurance undertakings should not consider contract boundaries as a single point in time, but as a boundary between the premiums and obligations that belong to the contract and the premiums and obligations that do not belong to the contract. Cash flows related to premiums and obligations that belong to the contract should be projected using realistic assumptions, which means that the projection of cash flows might go beyond any of the dates referred to in Article 18(3) of the Delegated Regulation.

Guideline 5 - Contract Boundaries (Amended Guideline)

2. Insurance and reinsurance undertakings should assess whether at recognition date it is possible to unbundle a contract and, at each valuation date, consider whether there has been any change, which would affect the previous assessment.
3. Insurance and reinsurance undertakings should consider that a contract can be unbundled for the purpose of contract boundaries if and only if two (or more) parts of the contract are equivalent in terms of risk to two (or more) contracts that could be sold separately. For the purposes of this Guideline, two contracts should be considered to be equivalent in terms of risk if there are no discernible differences in the economics of the contracts regarding the insurance or financial risk borne by the undertaking.
4. Notwithstanding the previous point, where all the parts of a contract have the same contract boundary, as a simplified approach undertakings may consider not to unbundle the contract for the purpose of setting contract boundaries.
5. When an option or guarantee covers more than one part of the contract, insurance and reinsurance undertakings should determine whether it is possible to unbundle it or whether it should be attributed to the relevant part of the contract.
6. If a contract is considered an insurance contract under Solvency II Directive, insurance and reinsurance undertakings should consider all unbundled parts of the contract to give rise to insurance or reinsurance obligations.
7. If a contract is unbundled for the purposes of assessing contract boundaries, each part should be treated as an independent contract.

Guideline 6 - Identification of a discernible effect on the economics of a contract (Deleted Guideline)

Guideline 6A - Identification of a financial guarantee of benefits with a discernible effect on the economics of a contract (New Guideline)

8. When determining whether a financial guarantee has no discernible effect on the economics of a contract, insurance and reinsurance undertakings should take into account all potential future cash flows, which may arise from the contract.
9. Insurance and reinsurance undertakings should consider a financial guarantee of benefits as having a discernible effect on the economics of a contract only if the financial guarantee is linked to the payment of the future premiums and provides the policyholder with a discernible financial advantage.
10. When determining whether a financial guarantee provides for a discernible financial advantage, insurance and reinsurance undertakings should consider the extent to which the whole set of future cash flows is expected to discernibly change if the financial guarantee did not exist. Undertakings can assess this on qualitative or quantitative basis.
11. The qualitative assessment should consider whether the configuration (risk, timing and amount) of the cash flows of the contract with the financial guarantee discernibly differs from the configuration of the contract without the financial guarantee.
12. The quantitative assessment should be based on whether the relative difference in the value of all future obligations related to the contract with and without the financial guarantee (“value of the financial guarantee”) on an expected present value basis is discernible. When calculating the value of the obligations without the financial guarantee, insurance and reinsurance undertakings should assume cash flows equal to the amount that would be paid if the financial guarantee did not exist. For contracts where the benefits depend on market returns undertakings should assume benefits that are consistent with relevant risk-free interest rate term structure used to calculate the best estimate as referred to in Article 77(2) of Solvency II Directive, without volatility adjustment and matching adjustment. When calculating the value of the obligations with the financial guarantee, insurance and reinsurance undertakings should consider in the valuation any form of guaranteed benefits stemming from the financial guarantee. Proper consideration of the time value of options and guarantees is relevant for this assessment.

Guideline 6B - 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 (New Guideline)

13. When determining whether the coverage for a specified uncertain event that adversely affects the insured person (cover) has no discernible effect on the economics of a

contract, insurance and reinsurance undertakings should take into account all potential future cash flows, which may arise from the contract.

14. Insurance and reinsurance undertakings should consider a cover as having a discernible effect on the economics of a contract only if the cover is linked to the payment of the future premiums and provides the policyholder with a discernible financial advantage.
15. When determining whether a cover provides a discernible financial advantage, insurance and reinsurance undertakings should consider the extent to which the whole set of future cash flows is expected to discernibly change if the cover did not exist. Insurance and reinsurance undertakings can assess this on qualitative or quantitative basis.
16. The qualitative assessment should consider whether the configuration (risk, timing and amount) of the cash flows of the contract with the cover discernibly differs from the configuration of the contract without the cover.
17. The quantitative assessment should be based on whether the 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. When calculating the value of the obligations without the cover insurance and reinsurance undertakings should assume that the cover does not exist. When calculating the value of the obligations with the cover insurance and reinsurance undertakings should consider all obligations. Considering potential future scenarios in some cases is relevant for this assessment.

Guideline 6C - Reassessment of the discernible effect of a cover or financial guarantee (New Guideline)

18. Insurance and reinsurance undertakings should keep contract boundaries constant through the whole life of a contract in almost all cases. However, due to changes of the external environment as defined in Article 29 of the Delegated Regulation as well as changes in the terms of the contract, contract boundaries may need to be amended.
19. Insurance and reinsurance undertakings are not expected to reassess whether a cover or financial guarantee has a discernible effect at each valuation date. However, insurance and reinsurance undertakings should perform this reassessment if there is indication that it may lead to a different conclusion. In particular, to assess changes in the economic environment undertakings should compare the current economic environment to the economic environment existing when the assessment used to define the current contract boundaries was performed and do a reassessment only in case these changes are extreme. For this purpose, the changes on the relevant risk-free interest rate term structure used to calculate the best estimate as referred to in Article 77(2) of the Solvency

- II Directive that are less extreme than the interest rate stress of the Standard Formula should not be considered to be extreme.
20. Insurance and reinsurance undertakings should change contract boundaries after this reassessment only if the reassessment leads to a clearly different conclusion than the assessment performed to define the current contract boundaries.
 21. When the reassessment of the discernible effect of a cover or financial guarantee led to a change in contract boundaries resulting on a material impact on the valuation of technical provisions and the solvency of the undertaking, insurance and reinsurance undertakings should immediately report this change to the supervisory authority. In addition, insurance and reinsurance undertakings should consider this as a material change as referred to in Article 312(3) of the Delegated Regulation and include it in the annual report mentioned in that Article, including a detailed description of the reassessment and its impact on the solvency position of the undertaking.
 22. Otherwise, the assessment whether a cover or financial guarantee has a discernible effect on the economics of the contract should not change.
 23. Insurance and reinsurance undertakings should not reassess contract boundaries for the different scenarios used to calculate the best estimate using simulation methods nor for the stressed scenarios used to calculate the SCR.

Compliance and Reporting Rules

24. This document contains guidelines issued under Article 16 of Regulation (EU) No 1094/2010. In accordance with Article 16(3) of that Regulation, competent authorities and financial institutions are required to make every effort to comply with guidelines and recommendations.
25. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.
26. Competent authorities are to confirm to EIOPA whether they comply or intend to comply with these Guidelines, with reasons for non-compliance, within two months after the issuance of the translated versions.
27. In the absence of a response by this deadline, competent authorities will be considered as non-compliant to the reporting and reported as such.

Final provision on review

28. These Guidelines will be subject to a review by EIOPA.