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Consultation paper on the revision of the Guidelines on Contract Boundaries

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1. INTRODUCTION

1. General comments

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IRSG welcomes measures aimed at ensuring consistency of assessment of contract boundaries.
The measures introduced are likely to require additional resource and cost on the part of affected undertakings. Demonstrable benefit in the form of materially changed assessment of contract boundaries and technical provisions should be evident before introducing such additional requirements.
A proportionate approach should be applied in assessing the need for additional complexity in calculations emerging from these guidelines.
Application of the revised guidelines is assumed to be in 2022 (according to paragraph 1.18). Currently no transitional phase for revised guidelines application is foreseen. We believe that a transitional period of at least 3 years in order for undertakings to properly implement these changes, especially given the concurrent work required by institutions on IFRS 17 implementation.
Proposed changes increase the granularity of the calculation model. The effort to prove that the amendments could be immaterial seems to lie entirely on the insurance undertakings and it would be appreciated if sufficient demonstration of expected materiality of the changes could be performed before introducing new guidelines.
The IRSG suggests that the assessment of appropriate contract boundary methodology should in general be made at the start of a contract, i.e. at product design or new business stage, when product features are naturally under analysis, and that changes to the methodology should in general not be made when contracts are in force. We suggest that this should be taken into account in the guidelines.

2. GUIDELINES

2. Guideline 0 (NEW) - Contract Boundaries

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3. Guideline 5 (AMENDED) - Unbundling of the contract

2500 character(s) maximum

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

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The fee structure of the contract is not considered here. Although fee structures are generally related to the savings amount (e.g. percentage of fund), there might be a number of scenarios where a fixed fee brings a discernible effect on the economics of the contract. In inflationary scenarios, for instance, fees tend to increase so every fixed fee structure brings a 'guarantee' for the customer here.
The proposed changes in respect of unbundling of the contract (guideline 5) and identification of a financial guarantee of benefits with a discernible effect on the economics of a contract (guideline 6a) will have minor impact on Best Estimate for unit-linked products with a guaranteed and an investment part where the link between these two parts is premium allocation. This occurred as a relevant topic in specific CEE countries.
We would advise to refrain from too specific quantifications of the discernible impact notably at too granular HRG levels and should also avoid exacerbating volatility of BEs.
Therefore it would seem wise to make use of qualitative assessments based on stable approaches and refer to ORSAs for complete going concern modelling approaches.
The IRSG considers that the following text should be removed from paragraphs 2.9 and 2.14. "However, supervisory authorities may require a quantitative assessment from the undertaking and the result of this quantitative assessment should prevail." The IRSG notes that supervisors already have powers to request information from companies as part of the supervisory review process. We question whether, in that context, the proposed wording is necessary. This has the potential to become a form of required supervisory approval of technical provisions. It would be open to interpretation by supervisory authorities and could lead to inconsistency of approaches. At the very least, there should be an acknowledgement of the need for proportionality in this area.

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

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There may be a number of different situations and combinations which could change the way in which the contract affects the insured person and the effect of any guarantees, e.g. age, contract term, level of cover, payments, use of contract options, etc. It would be necessary to choose between different combinations to make judgement on whether the effect of options is discernible, and this might be difficult in the absence of data on business mix. This should be recognised (e.g. using averages, line of business levels, groups etc. may be appropriate depending on the circumstances).

We also draw attention to additional issues which relate to the interaction between the Delegated Regulation and these guidelines:
• Article 18-5 of level 2 basically says that future premiums providing a financial guarantee with a discernible impact on the economics of the contract should be projected. This is a broad definition that does not lose track of the “contract” whereas the guidelines may seem to refer to Homogeneous Risk Groups (HRGs), and could therefore lose track of the contract and its global economics and narrow too much the definition of the impact on the economics of the contract
• Trying to give a narrow quantitative definition of the impact of a financial guarantee in terms of amounts of best estimate (eg 0.5% as mentioned under 3.18) at one point in time may induce a lot of volatility in BEs by both changing the contract boundaries according to the results of the valuation at one point in time, notably in consideration of the financial and economic environment circumstances, and embedding the volatility of future premiums themselves.
It may also disregard other important risk management aspects such as liquidity issues and other economically relevant issues for the insurer such as EPIFPs. In absolute words, a discernible effect is not only a question of increase in BEs from the policyholder point of view but also a matter of global margins (EPIFPs) for the insurer.

6. Guideline 6c (NEW) - Reassessment of the discernible effect of a cover or financial guarantee

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3. EXPLANATORY TEXT

7. Explanatory text on Guideline 0 (NEW) - Contract Boundaries

2500 character(s) maximum

8. Explanatory text on Guideline 5 (AMENDED) - Unbundling of the contract

2500 character(s) maximum

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

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10. Explanatory text on Guideline 6c (NEW) - Reassessment of the discernible effect of a cover or financial guarantee

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4. IMPACT ASSESSMENT

11. Section 4.1. Procedural issues and consultation of interested parties

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12. Section 4.2. Problem definition

2500 character(s) maximum

13. Section 4.3. Objectives pursued

2500 character(s) maximum

Section 4.4. Policy Options

14. Section 4.4.1. Policy issue 1: Introduction of additional Guidelines vs status quo

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15. Section 4.4.2.Policy issue 2: Unbundling

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16. Section 4.4.3.Policy issue 3: Discernible effect

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Section 4.5. Analysis and impact of policy options

Section 4.5.1. Policy issue 1: Introduction of new Guidelines vs status quo

17. Policy option 1.1. Introduction of additional EIOPA Guidelines to provide clarity on how the calculation of technical provisions shall be applied by insurance and reinsurance undertakings.

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18. Policy option 1.2 Keeping the status quo of the current Guidelines.

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Section 4.5.2.Policy issue 2: Unbundling

19. Policy option 2.1 Contracts should be unbundled for valuation purposes where cash flows can be allocated to each part of the contract regardless of the (inter) dependencies among them.

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20. Policy option 2.2 Contracts should be unbundled for valuation purposes 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

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Section 4.5.3. Policy issue 3: Reassessment of the discernible effect

21. Policy option 3.1 Static contract boundaries. Whether a cover or financial guarantee has a discernible effect is determined at inception of the contract and does not depend on the economic environment.

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22. Policy option 3.2 Dynamic contract boundaries. Undertakings should perform a reassessment of the effect of a cover or financial guarantee where there is indication that it may lead to a different conclusion.

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Section 4.6. Comparison of Options

23. Section 4.6.1. Policy issue 1: Introduction of new Guidelines vs status quo

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24. Section 4.6.2.Policy issue 2: Unbundling

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25. Section 4.6.3. Policy issue 3: Reassessment of the discernible effect.

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ADDITIONAL COMMENTS

26. Please insert here any general comment not covered in the sections above.

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Contact

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