CONSULTATION PAPER ON THE REVISION OF THE GUIDELINES ON CONTRACT BOUNDARIES

EIOPA-BoS-21/301
11 June 2021

European Insurance and
Occupational Pensions Authority

Table of Contents

Responding to this paper

1.1 EIOPA welcomes comments on the proposal for additional Guidelines on Contract Boundaries.

1.2 Comments are most helpful if they:

a) contain a clear rationale; and

b) describe any alternatives EIOPA should consider.

1.3 Please send your comments to EIOPA by the **12th of November 2021** responding to the questions in the survey provided at the following link:

https://ec.europa.eu/eusurvey/runner/ContractBoundaries

Contributions not provided using the survey or submitted after the deadline will not be processed and therefore considered as they were not submitted.

Publication of responses

1.4 Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

1.5 Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA's rules on public access to documents[1].

1.6 Contributions will be made available at the end of the public consultation period.

Data protection

1.7 Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published. They will only be used to request clarifications, if necessary, on the information supplied. EIOPA, as a European Authority, will process any personal data in line with Regulation (EU) No 2018/1725 of the European Parliament and of the Council of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and decision No 1247/2002/EC. More information on data protection can be found at https://www.eiopa.europa.eu/legal-notice_en under the heading 'Legal notice'.

Consultation paper overview & next steps

1.8 EIOPA carries out consultations in the case of guidelines and recommendations in accordance with Article 16(2) of Regulation (EU) No

[1] Public Access to Documents

1094/2010. This Consultation Paper presents the draft Guidelines, including explanatory text.

1.9 The preliminary analysis of the expected impact from the proposed policy is covered under Section 4 Impact Assessment. This analysis will be complemented with the information request launched by EIOPA together with this consultation paper.

Next steps

EIOPA will consider the feedback received, publish a Final Report on the consultation and submit the Guidelines for adoption by its Board of Supervisors.

1. Introduction

1.10 In accordance with Article 16 of Regulation (EU) No 1094/2010[2] EIOPA issues these Guidelines to provide guidance on how insurance and reinsurance undertakings should apply the requirements of Directive 2009/138/EC[3] ("Solvency II Directive") and in Commission Delegated Regulation (EU) No 2015/35[4] ("Delegated Regulation"), on the boundaries of insurance and reinsurance contracts

1.11 The Guidelines are addressed to competent authorities as defined in Article 4(2) of Regulation (EU) No 1094/2010.

1.12 The Guidelines apply to both individual undertakings and *mutatis mutandis* at the level of the group[5].

1.13 These Guidelines should be read in conjunction with and without prejudice to the Solvency II Directive, the Delegated Regulation and EIOPA's Guidelines on contract boundaries. Unless otherwise stated in this document, the current guidelines of EIOPA's Guidelines on contract boundaries remain unchanged and continue to be applicable.

1.14 During the 2020 review of Solvency II EIOPA identified several divergent practices regarding contract boundaries assessment, as presented in the analysis background document[6] to EIOPA's Opinion on the 2020 review of Solvency II. Divergent practices require additional guidance to ensure a convergent application of the existing regulation on contract boundaries.

1.15 These Guidelines introduce new guidelines and amend current guidelines on topics that are relevant for the determination of contract boundaries, in particular regarding the assessment whether a cover or financial guarantee has a discernible effect on the economics of the contract and the identification of the contracts which can be unbundled.

1.16 The section "Guidelines" provides the new and amended Guidelines. The section "Explanatory text" in addition to the explanatory text highlights the amendments to existing Guidelines.

1.17 If not defined in these Guidelines, the terms have the meaning defined in the Solvency II Directive.

1.18 These Guidelines shall apply from XX-XX-2022.

[2] Regulation (EU) No 1094/2010 Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pension Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

[3] Directive 2009/138/EC Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), (OJ L 335, 17.12.2019, p. 1)

[4] Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), (OJ L 12, 17.1.2015, p. 1)

[5] As defined in Article 212 (1) of the Solvency II Directive

[6] https://www.eiopa.europa.eu/content/opinion-2020-review-of-solvency-ii_en

2. Guidelines

NEW: Guideline 0 – Contract boundaries

2.1. 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.

AMENDED: Guideline 5 – Unbundling of the contract

2.2. 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.

2.3. 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.

2.4. 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.

2.5. Insurance and reinsurance undertakings should, when an option or guarantee covers more than one part of the contract, determine whether it is possible to unbundle it or whether it should be attributed to the relevant part of the contract.

2.6. If a contract is considered to be an insurance contract under Solvency II, insurance and reinsurance undertakings should consider all unbundled parts of the contract to give rise to insurance or reinsurance obligations.

DELETED: Guideline 6 - Identification of a discernible effect on the economics of a contract.

NEW: Guideline 6a – Identification of a financial guarantee of benefits with a discernible effect on the economics of a contract

2.7. 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.

2.8. 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.

2.9. 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. However, supervisory authorities may require a quantitative assessment from the undertaking and the result of this quantitative assessment should prevail.

2.10. 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.

2.11. 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 benefits 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 Directive 2009/138/EC, 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.

NEW: 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

2.12. 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.

2.13. 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.

2.14. 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. However, supervisory authorities may require a quantitative assessment from the undertaking and this quantitative assessment should prevail.

2.15. 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.

2.16. 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 insurances and reinsurance undertakings should consider all obligations. Considering potential future scenarios in some cases is relevant for this assessment.

NEW: Guideline 6c – Reassessment of the discernible effect of a cover or financial guarantee.

2.17. 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, contract boundaries may need to be amended. If a financial guarantee depends on the lifetime performance of a contract (e.g. terminal bonus) then a reassessment should not be performed.

2.18. 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. 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 at the inception of the contract.

2.19. 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.

2.20. 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.

2.21. Otherwise, the assessment whether a cover or financial guarantee has a discernible effect on the economics of the contract should not change.

3. Explanatory text

NEW: Guideline 0 – Contract boundaries
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.

Explanatory text:

3.1. Contract boundaries determine the premiums and obligations that belong to the contract considering the rights and risks for the undertakings. Where the undertaking can compel the policyholder to pay the premium, the premium and the related obligations belong to the contract because the undertaking has the right to request and keep the premium. Where the undertaking has the obligation to accept new premiums and cover the related obligations, but does not hold the unilateral right to amend the premiums/benefits so that the premiums fully reflect the risk, these premiums and the related obligations belong to the contract because the undertaking has the obligation to cover the risks.

3.2. In most of the cases, paid-in premiums and the related obligations reflect a right and an obligation for the undertaking, i.e. the right to keep the premium and the obligation to cover the risk. Therefore, the premium and the related obligations belong to the contract.

3.3. However, under very specific circumstances, this may not be the case. For example, in case of a contract with a paid-in premium where either party can cancel the contract during a limited period of time, e.g. a few days after entering into it. In such a case, the undertaking does not have the right to keep the premium nor the obligation to cover the risk and, therefore, the premium and the related obligations do not belong to the contract.

3.4. In any case, contract boundaries only limit the premiums and obligations that belong to the contract, but do not limit the projection horizon of the cash flows steaming from these premiums and obligations. The following example illustrates this point:

3.5. Example 1: The contract covers the risk of the following year for premiums paid during the year (e.g. paid on the 31^{st} of December). If an insured event occurs, the actual payments (cash flows) may occur spread across three years. The undertaking has the right to amend any future premium so it fully reflects the risk. Valuation date: end of year t.

Date	t-3	t-2	t-1	t	t+1	t+2	t+3	t+4
Premium	100	100	100	100	100			
Obligation		Cover	Cover	Cover	Cover	Cover		
Cash flow projection		32	48	16				
			32	48	16			
				32	48	16		
					32	48	16	
						32	48	16
BE undiscounted				176				

3.6. The horizon of projection of future cash flows is not affected by the contract boundaries. Even if obligations from premiums received in t+1 do not belong to the contract, cash flows related to previous obligations should be projected beyond t+1.

3.7. Example 2: General account product with profit sharing features that matures after 8 years. At that date, the contract will be renewed on annual bases, even if the undertaking and the policyholder can cancel the contract one month before the renewal date.

3.8. In this case, the undertaking should do a realistic projection of future cash flows, which should include assumptions on the future renewals after the eighth year of projection. However, under the proportionality principle, undertakings may assume the contract will be terminated after 8 years with a lump sum payment where this simplified approach does not lead to an underestimation of the Best Estimate.

AMENDED: Guideline 5 – Unbundling of the contract

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.

~~Insurance and reinsurance undertakings should determine whether it is possible to unbundle a contract by assessing whether two or more parts of the contract are clearly identifiable, and for which it is possible to define different sets of obligations and premiums attributable to each part.~~

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.

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.

Insurance and reinsurance undertakings should, when an option or guarantee covers more than one part of the contract, determine whether it is possible to unbundle it or whether it should be attributed to the relevant part of the contract.

If a contract is considered to be an insurance contract under Solvency II, insurance and reinsurance undertakings should still consider all unbundled parts of the contract to give rise to insurance or reinsurance obligations.

Explanatory text:

3.9. Unbundling can be performed at two different levels or stages of the valuation process:

a) Unbundling for cash flow projection purposes: The first step for best estimate valuation is the projection of cash flows. Where a contract has different parts, the cash flows of each part may be independent, the cash flows of one part may depend on the other (dependency) or the cash flows of each part may depend on the other parts (interdependency). Where material (inter)dependency exists, unbundling for cash flow projection purposes is not possible: in case of unbundling the dependency among cash flows would be lost. Therefore, in such a case, cash flows should be projected for the whole contract altogether.

b) Unbundling for valuation purposes: The second step for best estimate valuation is to determine which cash flows belong to the contract, i.e. which cash flows will be included in the best estimate. The key criteria for that purpose is Article 18 of the Delegated Regulation.

3.10. In most of the cases, where unbundling for cash-flow projection purposes is not possible, undertakings should not unbundle the contract for valuation purposes. However, in some cases a contract may be equivalent in terms of risk to the sum of two independent contracts that could be sold independently. In such a case, not unbundling the contract could lead to different contract boundaries compared to two independent contracts, while in terms of risk no discernible differences exist.

3.11. Therefore, any contract that is equivalent in terms of risk to two (or more) parts of the contract could be sold independently should be unbundled. To assess such equivalence only insurance and financial risk should be considered and non-discernible differences should not prevent the contract from being unbundled.

3.12. For this reason, dependencies at the level of the premium usually do not prevent a contract from being unbundled. For example, a contract with two parts, general account plus unit linked, where the policyholder may chose the percentage of premium allocated to each part. In this case, the dependency exists only at the level of the premium, but there is no discernible difference in terms of insurance or financial risk compared to two independent contracts (general account and unit linked). Therefore, this contract should be unbundled.

3.13. Conversely, dependencies in terms of risk should prevent a contract from being unbundled unless they are not discernible. For example, a unit linked contract with a mortality cover equal to the maximum between a fixed amount (sum insured) and the value of the unit-linked fund. In this case, the risk of the mortality cover depends on the unit-linked fund, so this contract should not be unbundled.

NEW: Guideline 6a – Identification of a financial guarantee of benefits with a discernible effect on the economics of a contract

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.

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.

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. However, supervisory authorities may require a quantitative assessment from the undertaking and the result of this quantitative assessment should prevail.

The qualitative assessment should consider whether the configuration of the cash flows of the contract with the financial guarantee discernibly differs from the configuration of the contract without the financial guarantee.

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 benefits 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 the relevant risk-free interest rate term structure used to calculate the best estimate as referred to in Article 77(2) of the Directive 2009/138/EC, 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 financial guarantees is relevant for this assessment.

Explanatory text:

3.14. The qualitative assessment may be based on any relevant considerations that provide evidence whether the financial guarantee provides a discernible effect on the economics of the contract. For example, undertakings may consider whether the financial guarantee is deeply in or out of the money or whether the price of the guarantee represents only a small percentage of the annual investment management fees charged to the policyholder.

3.15. The quantitative assessment should be based on all future obligations related to the contract. This means that should include obligations related to paid-in and future premiums. This also means that, for the purposes of the assessment, all obligations related to the contract should be considered regardless of contract boundaries.

3.16. To properly consider the time value of the financial guarantee stochastic valuation is usually necessary. This could be achieved using simulation methods based on probability-weighted potential future scenarios, as well as with some closed-formula approaches for simple cases.

3.17. The assessment, in particular where quantitative, may depend on contract-specific features (e.g. age of the policyholder). Insurance and reinsurance undertakings are not expected to perform the analysis on a contract-by-contract basis and the analysis should consider average features at product level.

3.18. In some cases the outcome of the quantitative assessment will require little additional considerations. For example, if the stochastic value of the financial guarantee over the value of all future obligations is only 0.5%, the financial guarantee will usually be considered not to have a discernible effect on the economics of the contract, but if the ratio is 2% it will usually be considered to have a discernible effect on the economics of the contract. However, in some cases further qualitative considerations may be needed, e.g. whether the effect of the financial guarantee is increasing, decreasing or constant through the life of the contract. It should also be noted that the value of the financial guarantee using deterministic valuation will usually be lower than its stochastic value.

3.19. In some cases, benefits may not depend on market returns at all. In such a case, it may be reasonable to use a benchmark that is not linked to the market, e.g. constant capital.

3.20. For the purpose of this assessment, future discretionary benefits whose allocation is absolutely voluntary for the undertaking, the expected payments should not be considered since they do not create any insurance nor financial risk for the undertaking. For this purposes, allocation of future discretionary benefits is absolutely voluntary where there is no legal nor contractual obligation to specifically allocate profits to one policyholder or group of policyholders or to unspecifically reserve profits for a future specific allocation to policyholders.

NEW: 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.

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.

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.

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. However, supervisory authorities may require a quantitative assessment from the undertaking and this quantitative assessment should prevail.

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.

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.

Explanatory text:

3.21. The qualitative assessment may be based on any relevant considerations that provide evidence whether the cover provides a discernible effect on the economics of the contract. For example, for contracts combining a savings part and a cover undertakings may consider whether the sum insured for the cover is very low in comparison to the principal of the contract or whether the price of the cover represents only a small percentage of the annual investment management fees charged to the policyholder.

3.22. The quantitative assessment should be based on all future obligations related to the contract. This means that should include obligations related to paid-in and future premiums. This also means that, for the purposes of the assessment, all obligations related to the contract should be considered regardless of contract boundaries.

3.23. To properly consider the value of the guarantee, probability-weighted potential future scenarios should be considered where relevant. This may include, for example, cases where the cover (e.g. mortality cover) is providing a financial guarantee (e.g. minimum return in case of death). For the quantitative assessment, stochastic valuation allows such consideration.

3.24. The assessment, in particular where quantitative, may depend on contract-specific features (e.g. age of the policyholder). Insurance and reinsurance undertakings are not expected to perform the analysis on a contract-by-contract basis and the analysis should consider average features at product level.

3.25. In some cases the outcome of the quantitative assessment will require little additional considerations. For example, if the value of the cover over the value of all future obligations is only 0.5%, the cover will usually be considered not to have a discernible effect on the economics of the contract, but if the ratio is 2% it will usually be considered to have a discernible effect on the economics of the contract. However, in some cases (e.g. 1%) further qualitative considerations may be needed, e.g. whether the effect of the cover is increasing, decreasing or constant through the life of the contract.

NEW: Guideline 6c – Reassessment of the discernible effect of a cover or financial guarantee

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, contract boundaries may need to be amended. If a financial guarantee depends on the lifetime performance of a contract (e.g. terminal bonus) then a reassessment should not be performed.

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. 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 at the inception the contract.

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.

Otherwise, the assessment whether a cover or financial guarantee has a discernible effect on the economics of the contract should not change.

Explanatory text:

3.26. Changes in the economic environment may have an impact on the assessment whether a cover or, in particular, a financial guarantee has a discernible effect on the economics of the contract.

3.27. While Guidelines 6a and 6b already envisage the consideration of potential future scenarios (e.g. using stochastic valuation in the quantitative assessment), changes in the economic environment may require a reassessment to ensure that contract boundaries properly reflect the risk borne by the undertaking.

3.28. The size of the change on the economic environment required to justify a change in contract boundaries depends on the characteristics of the contract. For example, financial guarantees deeply in or out of the money usually require larger changes in the economic environment to justify a change in the assessment than financial guarantees at the money. However, contract boundaries are expected to remain constant in most of the cases and should only be amended if the outcome has clearly changed. An indication to consider that the outcome has clearly changed is the expectation that it will not change back in the near future.

3.29. For contracts with a financial guarantee that is independent for each premium, e.g. a guaranteed annual interest rate, a new effect of the guarantee starts with each premium paid. Therefore, this reassessment ensures that the treatment of all equivalent obligations, i.e. affected by the same financial guarantee, is consistent regardless the date when the contract was issued.

3.30. However, where the financial guarantee affects all the premiums of the contract as a whole (e.g. terminal bonuses) the effect of the financial guarantee over the future premiums is linked to the effect of the financial guarantee over the already paid-in premiums. Therefore, in this case it is not necessary to perform the reassessment to ensure that all equivalent obligations have a consistent treatment. In these cases, the reassessment would be more complex, it could lead to frequent changes in contract boundaries and it is not justified by the fact that a new effect of the financial guarantee starts with each payment of a premium. For this reasons, these financial guarantees should not be reassessed.

3.31. Where the reassessment leads to a change in the contract boundaries, this should be considered to be a material change as describe in article 312(3) of the Delegated Regulation and therefore the undertaking should include a detailed description of the reassessment and its impact on the solvency position of the undertaking in the annual report mentioned in that article. If the undertaking was already issuing that annual report, this information should be included within the same report. If no other material change triggered the need to issues that annual report, the undertaking should specifically issue it to cover this information.

4. Impact assessment

4.1. Procedural issues and consultation of interested parties

4.1. In accordance with Article 16 of EIOPA Regulation, EIOPA has conducted analyses of costs and benefits during the policy development process. The analysis of costs and benefits is undertaken according to an impact assessment methodology.

4.2. This impact assessment covers the two main topics revised: unbundling of different parts of a contract and the assessment whether a cover or financial guarantee have a discernible effect on the economics of the contract. It is based on the qualitative assessment of the potential impacts done by EIOPA with some quantitative analysis based on prudential reporting data (QRTs). However, to adequately assess the impact of the proposals on these two topics, EIOPA considers that additional data is needed. For this reason, EIOPA is launching an information request together with this consultation paper.

4.2. Problem definition

4.3. Following the entry into force of the Solvency II Directive, especially the publication of the Delegated Regulation, EIOPA has adopted several sets of Guidelines that aim at clarifying expectations of the supervisors towards a correct implementation of the regulation by insurers. However, those Guidelines were not issued after a review of actual practices, as the time between application and implementation of Solvency II was not sufficiently long to study the industry’s practices and the industry’s understanding of the regulation.

4.4. During the preparation of EIOPA Opinion on the 2020 review of Solvency II, EIOPA has identified several divergent practices among insurers and supervisors regarding the assessment of contract boundaries. Those issues have been presented in the consultation paper, published in October 2019 and were especially explained in the Annex 3 of that document.

4.5. Globally, those divergent practices were mainly due to lack of clear explanations regarding the appropriate application of some provisions of the Delegated Regulation, mainly regarding unbundling of different obligations and the assessment whether a cover or financial guarantee has a discernible effect on the economics of the contract.

4.6. Some insurance contracts include different obligations that should be unbundled to determine contract boundaries when they are clearly identifiable. However, there are different interpretation when two parts of a contract are clearly identifiable. This interpretation can be grouped in two main approaches. The first one, unbundling a contract for contract boundary purposes only when it can be unbundled for cash-flow projection purposes, i.e. where there are no dependencies among each part of the contract. The second one, unbundling a contract when the cash flows of the contract can be allocated to each part of the contract. The second approach leads to unbundling more contracts than the first one, which in some cases has a material impact on contract boundaries and therefore on the best estimate and the own funds.

4.7. Regarding the discernible effect of covers and guarantees, the assessment significantly varies across different Member States. While it may be reasonable to use different assessments in some cases, the conclusions for similar products should be consistent and currently undertakings and NCAs are reaching different conclusions for similar financial guarantees and covers. Also related to this, in some markets the discernible effect assessment is only performed at inception while in other countries discernible effect is reassessed following relevant changes on the economic environment, which in the long run could lead to material differences on the treatment of the same products across Europe.

4.3. Objectives pursued

4.8. The main objective of these Guidelines is to ensure a convergent approach regarding the assessment of contract boundaries across (re)insurance undertakings. This proposal sets out additional principle-based guidance complementing and amending the current guidelines in order to provide clarity on how the insurance and reinsurance undertakings should implement the requirements laid down in the Delegated Regulation. In particular, the concept of contract boundaries, the assessment whether a cover or financial guarantee has a discernible effect on the economics of the contract and unbundling a contract into different parts are addressed. This additional principle-based guidance aims at fostering convergence on practices within European Union.

4.9. The mentioned objective for the Guidelines are connected to the general objectives of the Solvency II framework (deepen the integration of the EU insurance market, enhance the protection of policyholders and beneficiaries and promote better regulation) and in particular they are connected to:

- improving the governance and risk management of insurance and reinsurance undertakings, and
- the convergence of supervisory methods.

4.10. The objective of the Guidelines are also consistent with the following objectives of EIOPA, as reflected in the founding Regulation of EIOPA:

- to ensure a sound, effective and consistent level of regulation and supervision;
- to ensure the transfer of risks related to (re)insurance activities is appropriately regulated and supervised; and
- to foster consumer protection.

4.4. Policy Options

4.11. With the aim to meet the objectives to clarify the application of assumptions and management actions, as set out in the previous section, EIOPA has analysed different policy options throughout the policy development process.

4.12. The section below reflects the most relevant policy options that have been considered in relation to the different aspects of valuation of technical provisions. We have also listed relevant options which have been discarded in the policy development process.

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

4.13. The following policy options have been identified:

1. **Policy option 1.1** Introduction of additional Guidelines to provide clarity on how the calculation of technical provisions shall be applied by insurance and reinsurance undertakings.
2. **Policy option 1.2** Keeping the status quo of the current Guidelines.

4.4.2. Policy issue 2: Unbundling

4.14. The following policy options have been identified:

1. **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.

2. **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.

4.4.3. Policy issue 3: Discernible effect – Highlighted policy issue

4.15. The following policy options have been identified:

1. **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.
2. **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.

4.5. Analysis and impact of policy options

4.16. This section provides an impact assessment of the policy issues described, although policy issues 2 and 3 require a more detailed quantitative analysis. For this reason, this public consultation includes also an information request to assess the quantitative impact of the revised set of Guidelines, in particular regarding unbundling and discernible effect.

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

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.*

4.17. On the basis of the analysis performed by EIOPA during the preparation of the consultation paper on the Opinion on the 2020 Review of Solvency II, EIOPA has identified a lack of convergent practices among several topics regarding the calculation of technical provisions. Those divergent practices are described especially in Section 1 of the Annex 3 of the aforementioned document and mainly affect interpretation of the legal provisions regarding the concept of contract boundaries, unbundling and discernible effect.

4.18. The existence of those divergent practices is often due to the lack of clarity of the existing guidelines or the absence of guidelines explaining expectation of supervisory authorities when (re)insurance undertaking implement the principle-based regulatory requirements of technical provisions.

4.19. As a consequence, EIOPA has an opinion that the introduction of additional and amended Guidelines on contract boundaries:

a) supports the (re)insurance undertakings in setting up contract boundaries, and therefore, ensures an enhanced level playing field among the undertakings; and

b) does not significantly modify the current expectations of supervisory authorities but provide more clarity and more transparency on the application of regulatory requirements.

4.20. The main purpose of this revision is to ensure a common understanding of contract boundaries that facilitates a convergent application across Europe without introducing any material change on the existing principles. Addressing divergent practices unavoidably requires slight adaptations from some stakeholders to ensure such convergence. Therefore, in terms of cost of compliance with the new Guidelines, it is reasonable to expect that some stakeholders may need to slightly adapt their processes to assess contract boundaries. However, considering that the new Guidelines intended to provide clarifications rather than changing any criteria, the cost at EU market level is not expected to be material.

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

4.21. This option has the lowest impact since it does not require any change from stakeholders. However, it fails to address the existing divergent practices that hamper the level playing field. This could be particularly relevant in case of activities performed through freedom of establishment of freedom of services. Indeed expectations regarding contract boundaries might differ from the Home supervisory authority and the Host supervisory authority, which could lead to different own funds' assessment for the same insurance obligations.

4.5.2.Policy issue 2: Unbundling

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.*

4.22. This option is expected to lead to unbundle a larger amount of contracts, although this does not mean that unbundling would be the approach "by default". There are several cases what where it would not be possible to unbundle. For example:

- Products where a financial guarantee covers two different parts altogether[7].
- Contracts that provide a material additional service that cannot be allocated to any of the parts of the contract.
- In general, any contract where there is a material cash flow that cannot be allocated to a part of a contract, usually due to complex interactions among the parts of the contract.

4.23. This option, in some cases, may lead to include a particular set of cash flows that may not be possible in reality. For example, in case of a contract where both parts would always lapse at the same time, having different contract

[7] E.g. an investment product with several sub-funds, some of which have an individual financial guarantee. The product also includes a terminal financial guarantee (e.g. annualised 2%) that covers the whole product.

boundaries for each part would lead to obligation from one part being projected longer than for the other, while this situation cannot really exist.

4.24. Besides, it could be complex to apply in some cases, for example regarding allocation of expenses to each part of the contract, which in the end could endanger convergence in best estimate valuation.

4.25. This option could have a material impact on the market since it may lead to unbundle some products that currently are not being unbundled. Since some Member States are already applying an approach similar to this one, it is possible to have a rough estimate of the maximum impact in terms of own funds. The estimate is based on unit linked products, which are the products more likely to be affected by this issue, and depart from two main assumptions:

- Unbundling a unit-linked product will usually lead to short contract boundaries.
- The analysis is based on the difference in the ratio of EPIFP over technical provisions among jurisdictions for unit-linked products. Jurisdictions with short contract boundaries for unit-linked product are used as a benchmark to estimate the impact for other jurisdictions.

4.26. The graph below shows the distribution of countries based on the percentage of undertakings that have short contract boundaries for unit-linked products and the weight of EPIFP over unit-linked technical provisions:

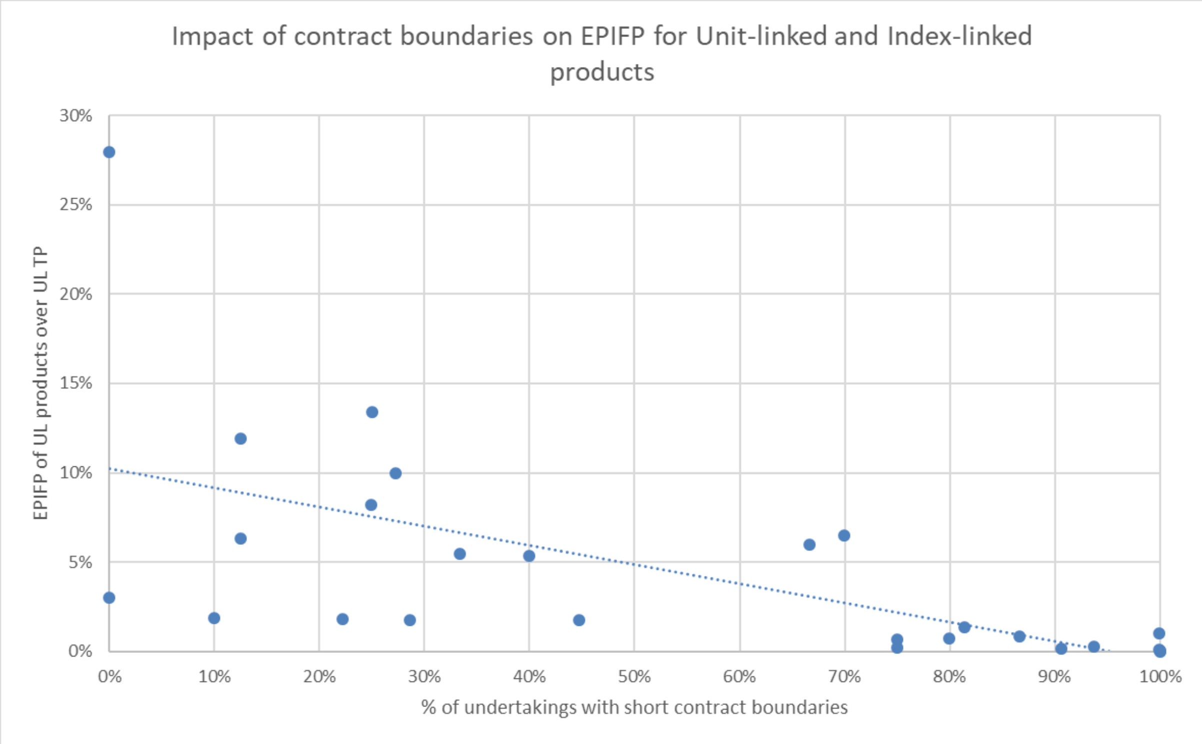

Image 1. Short and long contract boundaries in UL products

4.27. Regarding the impact on the own funds, the next graph summarizes the impact by Member State[8]. Bars highlighted in red represent Member States where the percentage of undertakings with long contract boundaries is higher than 60%.

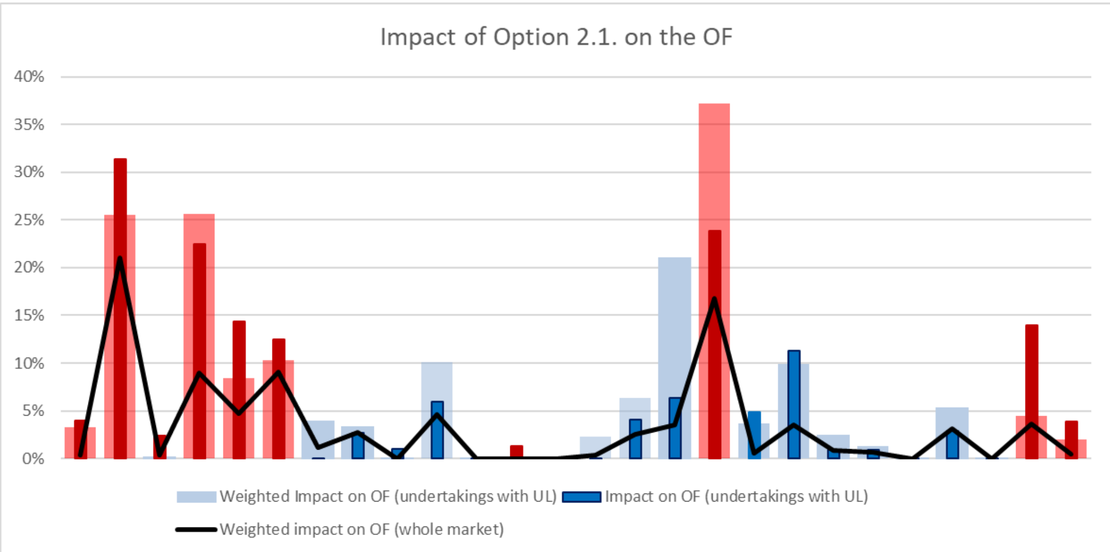

Image 2. Impact of Option 2.1 on the own funds

4.28. This assessment suggests that the impact would be in most of the jurisdictions below 5% of the own funds at market level (black line). It

[8] Some jurisdictions are not represented due to data quality issues, which left a sample too small to reflect any characteristics of the market.

should be noted that this analysis is probably overestimating the impact of the change since it does not consider differences in products regarding the level of EPIFP and, more importantly, regarding whether the product could be unbundled also under this option. Data quality and the high number of assumptions to derive this analysis only from QRTs data also require precaution while interpreting these results. For this reason, the analysis is presented without identifying Member States. Therefore, a more detailed analysis would be beneficial to have a clearer understanding of the impact of this alternative, so additional information is being requested to estimate the impact of this approach.

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*

4.29. This option is very close to unbundle a contract for valuation purposes where the contract can be unbundled for cash flow projection purposes, which bears significant merits:

- It is simpler to implement, since it requires unbundling in less cases than the previous option.
- It is closer to IFRS 17, which uses contract as unit, i.e. usually does not require unbundling of insurance obligations.
- It avoids the two main cons of the previous option.

4.30. However, non-material dependencies could prevent a contract from being unbundled, which could open the door for very similar having very different treatments in Solvency II just depending whether the products have been commercialized separately or altogether. For this reason, the criterion has been rephrased to ensure that combinations of products that are equivalent in terms of risk are treated consistently.

4.31. The impact of this option is not expected to be material in most of the cases since it is consistent with the approach followed in most of the jurisdictions, although in some particular cases a change may be needed.

4.32. Contracts not unbundled under this approach that were unbundled in the past should usually lead to an increase in the own funds of the undertakings. However, it is not possible to estimate the impact of this change with the data currently available for two main reasons:

- The level of EPFIP significantly varies from case to case when contract boundaries are long as we can see in the previous Image 1.
- Not unbundling a product does not necessarily mean that contract boundaries would be longer.

4.33. Contracts unbundled under this approach that were not unbundled in the past should usually lead to a decrease in the own funds. However, the impact in this second case is justified since not unbundling these products would hamper the level playing field, since one product with the same risks than two separate products would have different contract boundaries.

4.34. In any case, a more detailed analysis would be beneficial to have a clearer understanding of the impact of this alternative, so additional information is being requested to estimate the impact of this approach.

4.5.3. Policy issue 3: Reassessment of the discernible effect – HIGHLIGHTED POLICY ISSUE

4.35. Changes in the contract terms or the relevant external environment that may affect contract boundaries should trigger a reassessment. While this is clear for several changes (e.g. legal or technological environment), two different options were considered for the economic environment.

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.*

4.36. Under Option 3.1, discernibility of a cover or financial guarantee is a characteristic of the contract and should not depend on the economic environment. Therefore, the assessment performed at the inception of the contract should consider potential material future economic scenarios and analyse whether the cover or financial guarantee could be discernible in some of them. This means that the initial assessment should not change even in case of changes in the economic environment that would lead to a different conclusion if discernibility were be reassessed.

4.37. Option 3.1 would enhance stability since any reassessment can potentially lead to a change in contract boundaries, probably having a cliff-edge effect in the own funds. This option would usually result in consistent contract boundaries for all products. However, since contract boundaries cannot be reassessed, there is a risk that after a material change in the economic environment, contract boundaries for new contracts are different than contract boundaries for old contracts, even if the contracts are identical, in particular if the assessment is performed by different undertakings.

4.38. Performing an assessment that is really independent from the economic conditions is a major challenge, since it requires to consider potential future situations. However, if any possible future situation is considered, probably (almost) all covers and financial guarantees would be considered to be discernible since there will probably always be an extreme scenario where they have a discernible effect. Conversely, if only likely or realistic potential scenarios are considered, the notion of likely/realistic probably depends on the current economic environment. For example, 20 years ago negative interest rated probably would have been considered unrealistic.

4.39. This option would have not have any immediate impact on the market, since it does not allow any reassessment. Forward-looking, it would have an impact in the markets that currently follow a dynamic approach and reassess discernibility when the economic environment changes. However, contract boundaries are expected to remain constant in most of the cases even in market where the dynamic approach is the current standard. Therefore, the impact of this option is not expected to be very material even in the long-run in most cases. However, additional information is being requested to estimate the impact of this policy issue.

4.40. Current Guideline 1 on contract boundaries clarifies that the principles for determining contract boundaries are consistently applied to all insurance and reinsurance contracts, in particular over time. This is consistent with Option 3.1 where the contract boundary is static. It could also be considered to be consistent with Option 3.2, since application of the same principle may lead to different outcomes where the context has changed. This interpretation of Guideline 1 is also consistent with current Guideline 5, which requires unbundling to be reassessed at each valuation date.

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.*

4.41. Under Option 3.2, undertakings should perform a reassessment at valuation date where there is indication that it may lead to a different conclusion. However, undertakings should change contract boundaries after this reassessment only where the reassessment led to a clearly different conclusion than the assessment performed at inception.

4.42. Option 3.2 would ensure that the equivalent contracts always have the same treatment since it is allowed to reassess contract boundaries after relevant changes in the economic environment. However, it should be noted that this approach could lead to changes in contract boundaries more frequently, therefore increasing volatility of technical provisions and own funds and the burden for undertakings and supervisory authorities. In any case, under this option contract boundaries are still expected to remain constant in most of the cases, so the impact of this con is limited. Contract boundaries in particular may change in times of financial crisis, which could lead to procyclical or countercyclical effects depending on the case.

4.43. Even if contract boundaries may be reassessed after changes in the economic environment, contract boundaries should not be reassessed in the calculation of the SCR scenarios, even for those that are stressing the economic environment, i.e. contract boundaries do not change in SCR calculations. The objective of the SCR is to assess the losses that the undertaking would face in extreme (1 in 200) scenarios. However, changes in contract boundaries do not reflect losses for the undertaking but only changes in the scope of the valuation of best estimate, so they should not be considered. Similarly, while performing stochastic valuation, some scenarios considered within the valuation process could trigger a reassessment of contract boundaries. This should not be considered within the stochastic valuation process since changes in contract boundaries do not reflect a change in the expected cash flows but a change in the scope of obligations to be included in best estimate. Therefore, contract boundaries should remain constant through all the scenarios in the stochastic valuation to ensure that the valuation is consistent with the contract boundaries determined at the valuation date.

4.44. The immediate impact of this option is probably immaterial. The low yield environment further declined since the inception of Solvency II, therefore discernibility for most of the products with a financial guarantee is not expected to have changed. Forward-looking, it would have an impact in the markets that currently follow a static approach and do not reassess discernibility when the economic environment changes.

4.45. In any case, the assessment of discernible effect considers potential future economic environments (e.g. via stochastic valuation) and, indeed, contract boundaries are expected to remain constant in most of the cases. Besides, in any case contract boundaries should only change where the outcome of the assessment is clearly different. For these reasons, EIOPA considers that the impact of this option is not very material. However, additional information is being requested to estimate the impact of this policy issue.

4.6. Comparison of options

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

4.46. EIOPA believes that, without the introduction of additional Guidelines, the current set of Guidelines on contract boundaries fail to provide a sufficient regulatory framework for the insurance and reinsurance undertakings and the national competent authorities as shown by the current divergent practices.

4.47. The following table shows the main costs and benefits for EIOPA stakeholders:

Policy issue 1: Introduction of new Guidelines vs status quo		
Option 1.1: Introduction of additional Guidelines		
Costs	Policyholders	None
	Industry	Some undertakings may need to do some adjustments regarding best estimate valuation to comply with the revised Guidelines. However, this is unavoidable when addressing divergent practices.
	Supervisors	Some undertakings may need to do some adjustments regarding best estimate supervision to comply with the revised Guidelines. However, this is unavoidable when addressing divergent practices.
	Other	None
Benefits	Policyholders	More consistent level of protection across Europe.
	Industry	Enhanced level playing field and consistent supervision across Europe.
	Supervisors	Clearer guidance facilitating the level playing field and a common understanding with industry.

	Other	None
Option 1.2: No change		
Costs	Policyholders	Different level of protection depending on the interpretation of SII principles in each jurisdiction.
	Industry	Different interpretations in different markets, hampering the level playing field and creating challenges for undertakings operating in several markets.
	Supervisors	Lack of clear guidance on the interpretation of some provisions complicates reaching a common understanding with the industry.
	Other	None
Benefits	Policyholders	None
	Industry	None
	Supervisors	None
	Other	None

4.48. For these reasons, Option 1.1 is preferred.

4.6.2. Policy issue 2: Unbundling

4.49. EIOPA believes that Option 2.2 better reflects the approach currently being followed in most of the cases and is closer to IFRS 17, therefore, minimizing the impact for undertakings. EIOPA also considers that this option clearly reflects the main objective of unbundling: ensuring a consistent approach for products equivalents in terms of risk regardless of their commercial structure.

4.50. The following table shows the main costs and benefits for EIOPA stakeholders:

Policy issue 2: Unbundling		
Option 2.1: Unbundling when the cash flows of the contract can be allocated to each part of the contract.		
Costs	Policyholders	None
	Industry	- Some undertakings would need to adjust their unbundling assessment process to this approach. However, this is unavoidable when addressing divergent practices. - Allocation of some cash flows (e.g. some expenses) could be complex and/or require material expert judgement, complicating the assessment.
	Supervisors	- Some supervisory authorities would need to adjust their supervisory practices to this approach. However, this is unavoidable when addressing divergent practices. - Allocation of some cash flows (e.g. some expenses) could be complex and/or require material expert judgement, complicating its supervision.

	Other	None
Benefits	Policyholders	- This approach would usually lead to higher technical provisions compared to Option 2.2 and therefore to a higher level protection of policyholders. - Same level of protection across Europe.
	Industry	- Clearer guidance reducing uncertainty. - Consistent treatment of the same products across Europe enhancing the level playing field.
	Supervisors	- Clearer guidance
	Other	None
Option 2.2: Unbundling when the parts of the contract could be sold separately		
Costs	Policyholders	None
	Industry	- Some undertakings would need to adjust their unbundling assessment process to this approach. However, this is unavoidable when addressing divergent practices.
	Supervisors	- Some supervisory authorities would need to adjust their supervisory practices to this approach. However, this is unavoidable when addressing divergent practices.
	Other	None
Benefits	Policyholders	- Same level of protection across Europe.
	Industry	- Clearer guidance reducing uncertainty. - Consistent treatment of the same products across Europe enhancing the level playing field. - Closer to IFRS 17
	Supervisors	- Clearer guidance - Closer to IFRS 17
	Other	None

4.51. For these reasons, Option 2.2 is preferred.

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

4.52. EIOPA has identified that different approaches are currently being followed in different jurisdictions and therefore further guidance on the right approach is needed to guarantee the level playing field.

4.53. The following table shows the main costs and benefits for EIOPA stakeholders:

Policy issue 3: Reassessment of the discernible effect		
Option 3.1: Static contract boundaries		
Costs	Policyholders	None

	Industry	- Some undertakings would need to adjust their discernible effect assessment process to this approach. However, this is unavoidable when addressing divergent practices. - Complexity of the initial assessment to ensure it is relevant in different economic environments. - Risk of inaccurate assessment after material changes in the economic environment. If the product is still commercialised, the undertaking would need to change the approach for new contracts, leading to different assessment for equivalent products only due to the date when they were issued.
	Supervisors	- Some supervisory authorities would need to adjust their supervision of the discernible effect assessment to this approach. However, this is unavoidable when addressing divergent practices. - Complexity of the initial assessment to ensure it is relevant in different economic environments. - Risk of inaccurate assessments after material changes in the economic environment
	Other	None
Benefits	Policyholders	None
	Industry	- Clearer guidance reducing uncertainty. - No cliff-edge effects on the own funds since contract boundaries are not reassessed.
	Supervisors	- Clearer guidance.
	Other	None
Option 3.2: Dynamic contract boundaries		
Costs	Policyholders	None
	Industry	- Need to reassess contract boundaries when changes on the economic environment are relevant for the assessment. - In some cases, cliff-edge effect on the own funds when the reassessment leads to a different outcome.
	Supervisors	None
	Other	None
Benefits	Policyholders	- Ensuring that equivalent products will have the same level of protection regardless the date when they were issued.
	Industry	- Clearer guidance reducing uncertainty. - More accurate assessment after relevant changes in the economic environment. - Ensuring that equivalent products will have the same treatment regardless the date when they were issued.
	Supervisors	- Clearer guidance - More accurate assessment after relevant changes in the economic environment. - Ensuring that equivalent products will have the same treatment regardless the date when they were issued.
	Other	None

4.54. For these reasons, Option 3.2 is preferred.

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