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Guidelines on Contract Boundaries – Consolidated Version

European Insurance and Occupational Pensions Authority

Guideline 0 - Contract Boundaries

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 1 - Consistent application of the principles

2. Insurance and reinsurance undertakings should ensure that the principles for determining contract boundaries are consistently applied to all insurance and reinsurance contracts, in particular over time.

Guideline 2 - Unilateral right

3. Insurance and reinsurance undertakings should consider the right to terminate, reject, or amend premiums or benefits payable under an insurance or reinsurance contract as being unilateral when neither the policy holder nor any third party can restrict the exercise of that right. For the purpose of this guideline, third parties do not include supervisory authorities and governance bodies of insurance and reinsurance undertakings.
4. In particular:
   a) Where, in order to put the amendment of premiums and benefits into effect, the insurance or reinsurance undertaking is required to obtain an external assessment in accordance with the law or the terms and conditions of another agreement outside the insurance or reinsurance contract, the existence of such a requirement should limit the unilateral right of the undertaking only if the assessment gives the policy holder or any third party the right to interfere with the use of that right.
   b) Undertakings should not consider reputational risk or competitive pressures as limitations of the unilateral right.
   c) Undertakings should consider that national laws limit their unilateral right only if these laws restrict or give the policyholder or any third party the right to restrict the exercise of that right.

d) Undertakings should disregard the right to unilaterally amend the premiums or the benefits payable under the contract if the premiums or benefits payable depend solely on the decisions of the policy holder or the beneficiary.

e) Undertakings should disregard the right to unilaterally terminate the contract or reject premiums payable under the contract if the exercise of this right, as specified in the terms and conditions of the contract, is conditional on the occurrence of a claim event.

Guideline 3 - Ability to compel

5. Insurance or reinsurance undertakings should recognise their ability to compel a policy holder to pay a premium only if the policyholder's payment is legally enforceable.

Guideline 4 - Full reflection of the risk

6. When determining whether premiums are fully reflecting the risks covered by a portfolio of insurance or reinsurance obligations, insurance and reinsurance undertakings should assess whether, at the moment at which either premiums or benefits can be amended, under all circumstances the undertaking has the right to amend premiums or benefits such that the expected present value of the future premiums exceeds the expected present value of the future benefits and expenses payable under the portfolio.
7. For the purpose of assessing whether premiums are fully reflecting the risks covered by a portfolio of insurance or reinsurance obligations in accordance with Article 18 (3) and (7) of Commission Delegated Regulation 2015/35, insurance and reinsurance undertakings should ensure that this portfolio consists of obligations for which the insurance or reinsurance undertaking can amend premiums and benefits under similar circumstances and with similar consequences.
8. Insurance and reinsurance undertakings should take into account any individual assessment of relevant features of the insured person that allow the undertaking to gather sufficient information in order to form an appropriate understanding of the risks associated with the insured person. In the case of contracts covering mortality risks or health risks similar to life insurance techniques, the individual risk assessment can be a self-assessment by the insured person or can include a medical examination or survey.

Guideline 5 - Contract Boundaries

9. 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.

10. 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.
11. 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.
12. 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.
13. 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.
14. If a contract is unbundled for the purposes of assessing contract boundaries, each part should be treated as an independent contract.

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

15. 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.
16. 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.
17. 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.
18. 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.
19. 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

20. 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.
21. 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.
22. 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.
23. 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.
24. 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

25. 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.
26. 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.
27. 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.
28. 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.
29. Otherwise, the assessment whether a cover or financial guarantee has a discernible effect on the economics of the contract should not change.
30. 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.

Guideline 7 - Estimation of obligations

31. Insurance or reinsurance undertakings should, where details of a contract or the full extent of the obligations covered by a contract are not available to the undertaking at the time of recognition of the contract, estimate the boundaries of the contracts using all available information in a manner consistent with the principles set out in these Guidelines.
32. Undertakings should revise this estimated assessment as soon as more detailed information is available.

Guideline 8 - Reinsurance contracts

33. Insurance and reinsurance undertakings should, for their accepted reinsurance contracts, apply the provisions of Article 18 of Commission Delegated Regulation 2015/35 independently from the boundaries of the underlying insurance or reinsurance contracts to which they relate.

Compliance and Reporting Rules

34. 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.
35. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.
36. 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.
37. 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

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