**Recommendation No 3/2022**

**of the financial market supervision units of Národná banka Slovenska**

**of 12 September 2022**

**transposing the amended guidelines on contract boundaries for insurance and reinsurance undertakings issued by the European Insurance
and Occupational Pensions Authority (EIOPA)**

Národná banka Slovenska (hereinafter ‘NBS’) hereby transposes the Guidelines on Contract Boundaries and the amended Guidelines on Contract Boundaries issued by the European Insurance and Occupational Pensions Authority (hereinafter ‘EIOPA’) under the numbers
EIOPA-BoS-14/165 and EIOPA-BoS-2022/218.

**Article I**

**Introduction**

(1) In accordance with Article 16 of Regulation (EU) No 1094/2010 of 24 November 2010 (hereinafter ‘the EIOPA Regulation’), EIOPA has issued recommendations to provide guidelines on how insurance and reinsurance undertakings should apply requirements of Directive 2009/138/EC (hereinafter ‘the Solvency II Directive’) implemented in Act No 39/2015 on insurance (and amending certain laws) (hereinafter ‘the Insurance Act’), and requirements of Commission Delegated Regulation (EU) No 2015/35 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) (hereinafter ‘the Delegated Regulation’) specified in its Articles 17 and 18 on the scope of insurance or reinsurance contracts.

(2) The guidelines apply to insurance and reinsurance undertakings and promote a consistent application of an insurance or reinsurance contract scope, i.e. insurance or reinsurance contract boundaries. The guidelines provide guidance to determine which insurance or reinsurance obligations with regard to future premiums arise in relation to a contract in accordance with Articles 17 and 18 of the Delegated Regulation.

(3) For the purpose of these guidelines, the expression ‘governance bodies’ means internal bodies made up for the purpose of governing an insurance or reinsurance undertaking and which, as a result, must not be considered as a third party in the case they express a decision or an opinion on the exercise of the right to terminate a contract, to reject premiums payable under a contract or to amend the premiums or the benefits payable under the contract.

(4) If not defined in these guidelines, the terms have the meaning defined in the legal acts referred to in the introduction.

(5) The amended guidelines introduce new guidelines and supplement existing guidelines on topics that are relevant to determining the scope of a contract, particularly with respect to assessing whether the coverage or financial guarantee has a discernible effect on the economics of the contract and identifying contracts that may be carved out.

(6) The amended guidelines do not depart from the previous guidelines and only add additional detail compatible with the guidelines included in the previous guidelines. Therefore, the applicability of the amended guidelines should not lead to a reassessment of the scope of existing contracts. However, under the amended guidelines, a reassessment is to be conducted if there is an indication that the outcome would be different. Therefore, a reassessment of the scope of contracts is necessary after the guidelines enter into force if the previous assessment has differed significantly from the approach envisaged in the amended guidelines. In addition, any reassessment of the scope of contracts required under the amended guidelines should be carried out under the new guidelines, regardless of whether the contract had been underwritten before the amended guidelines became applicable.

(7) In accordance with Article 16(3) of the EIOPA Regulation, insurance and reinsurance undertakings shall make every effort to comply with the guidelines and recommendations.

**Article II**

**Guidelines**

**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.

**Guideline 1 – Consistent application of principles**

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**

1. 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.

2. 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) Insurance and reinsurance undertakings should not consider reputational risk or competitive pressures as limitations of the unilateral right.

c) Insurance and reinsurance 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) Insurance and reinsurance 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) Insurance and reinsurance 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**

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**

1. 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.

2. 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 the Delegated Regulation, 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.

3. 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 recognition of the risks associated with the insured person. In the case of contracts covering mortality risks or health risks similar to life insurance techniques, it may include a self-assessment by the insured person or can include a medical examination or opinion.

**Guideline 5 – Unbundling of the contract**

1. 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. 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 insurance or reinsurance undertaking.

3. 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.

4. 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.

5. If a contract is considered an insurance contract under the Insurance Act, insurance and reinsurance undertakings should consider all unbundled parts of the contract to give rise to insurance or reinsurance obligations.

6. If a contract is unbundled for the purposes of assessing contract boundaries, each part should be treated as an independent contract.

**Guideline 6 – Identification of financial guarantee with a discernible effect on the economics of a contract**

1. 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. 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.

3. 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.

4. 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.

5. 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 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 Section 38(2) of the Insurance Act, 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**

1. 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. 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.

3. 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.

4. 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.

5. 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**

1. 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.

2. 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 Section 38(2) of the Insurance Act that are less extreme than the interest rate risk stress scenarios of the standard formula should not be considered to be extreme.

3. 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.

4. 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 Národná banka Slovenska. 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 report to a supervisory authority and mentioned in that Article, including a detailed description of the reassessment and its impact on the solvency position of the insurance or reinsurance undertaking.

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

6. 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**

1. 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.

2. Insurance and reinsurance undertakings should revise this estimated assessment as soon as more detailed information is available.

**Guideline 8 - Reinsurance contracts**

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

**Article III**

**Final provisions**

1. Points (p) and (cc) in Article II of Recommendation No 1/2016 of the Financial Market Supervision Unit of Národná banka Slovenska of 15 January 2016 transposing Solvency II Guidelines of the European Insurance and Occupational Pensions Authority (EIOPA), are deleted. Points (a) to (cc) are renumbered as points (a) to (aa).
2. This Recommendation becomes effective on 1 January 2023.

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