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Guidelines on Contract Boundaries – Consolidated Version with Explanatory Text

European Insurance and Occupational Pensions Authority

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:

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.

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. 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. However, these cases will usually have an immaterial impact on the value of the best estimate liability of the undertaking, among others, due to the short period where both rights coexist. In such a case, undertakings might still consider that these obligations related to paid-in premiums belong to the contract.

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:

5. Example: The contract covers the risk of the following year for premiums paid during the year (e.g. paid on the 31st 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** **32**	**16** **48** **32**	**16** **48** **32**	**16** **48** **32**	**16** **48**	**16**
BE undiscounted				**176**				

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.

Guideline 1 - Consistent application of the 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

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.

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.

Explanatory text

7. In some jurisdictions the undertakings may amend the premiums and benefits only if a body consisting e.g. of representatives of policyholders agrees on it. To determine whether such a body has to be considered as part of the governance of the undertaking or as third party, undertakings have to assess the scope of its responsibilities and the extent to which such a

body is integrated into the structure and management of the undertaking. If the result of the assessment is that the body forms part of the management of the undertaking, this type of body is not to be considered as third party and its decisions or opinions are regarded as taken by the undertaking. Where the body is performing an oversight function independent of the undertaking, it is considered as third party for the purpose of Guideline 2. According to the definition provided in paragraph 1.4 of the EIOPA-BoS-14/165[1], the general assembly of a mutual insurance company can be considered as a governance body of such an undertaking.

8. Some premium or benefit changes agreed upon at inception of the contract may depend on factors beyond the control of the undertaking (e.g. inflation, increase of salary). Such a change is not to be considered an amendment in terms of contract boundaries provided that the same premium structure as agreed at the inception of the policy is used. E.g. lapses of such policies are considered as being policy holder behaviour in accordance with article 32 of the Implementing Measures. In the terms and conditions of the policy, a certain payment or benefit plan is often agreed upon. The mere existence of such an agreement does not imply in itself that a change as a result of the payment or benefit plan would be regarded as an amendment in terms of contract boundaries. The same applies to the mere existence of a predefined bonus/malus system.

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.

Explanatory text

9. The undertaking does not have the ability to compel the policyholder to pay the premium where the payment of the premium is not legally effective and enforceable. For instance, the holding by the insurance undertaking of the Bank Identifier Code of policy holders is not a means for insurers to compel policy holders to pay the premiums in particular for contracts with scheduled future premiums.

Guideline 4 - Full reflection of the risk

[1] Introduction to the original Guidelines on Contract Boundaries.

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.

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.

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.

Explanatory text

10. The payment of the future premiums that belong to a contract may be predicated on the occurrence of an event or be determined by the value of sets of financial or non-financial variables. Therefore, a premium does not need to be certain in its timing or amount to belong to the contract.

11. For example, when a future premium payment meets all the conditions to belong to the contract and where the receipt of the premium is conditional on the occurrence of a specified event, the premium belongs to the contract. Determining the probability of the specified event occurring is relevant for valuation purposes but not for the determination of the boundary of the contract.

12. Future management actions, such as granting discretionary benefits, do not affect the contract boundaries, but are taken into account when calculating best estimate in accordance with Articles 30 and 31 of the Implementing Measures. Also discounts preapproved by the undertaking may sometimes be considered to be part of the payment schedule.

13. There is no need to calculate policy by policy the present value of the premiums payable or benefits and expenses payable but an overall assessment on portfolio level is enough. For the purpose of the guidelines on contract boundaries, a ‘portfolio of obligations’ does not necessarily only refer to a collection of obligations with similar characteristics. The portfolio of obligations within these guidelines consists of those collections of obligations where the insurance or reinsurance undertaking can amend premiums and benefits under similar circumstances and with similar consequences.

Guideline 5 - Contract Boundaries

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 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.

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.

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.

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

Explanatory text

14. 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.

15. 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.

16. 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. Conversely, dependencies in terms of risk should prevent a contract from being unbundled unless they are not discernible. To assess such equivalence, only insurance and financial risk should be considered and non-discernible differences should not prevent the contract from being unbundled.

17. For example, a unit-linked contract with a mortality cover where the payout in case of death is equal to the sum of a fixed amount (sum insured) plus the value of the fund should be unbundled as there is no connection between the risks of each part. The first part would be a unit-linked component to be paid in any case (death or survival), and the second component would be the mortality cover guaranteeing an additional sum insured in case of death. Conversely, in case of a unit-linked contract with a mortality cover where the payout in case of death is equal to the maximum between a fixed amount (sum insured) and the value of the unit-linked fund, the risk of the mortality cover depends on the unit-linked fund, so this contract should not be unbundled.

18. In some cases, cash flows are projected for a group of contracts altogether but contract boundaries may be different for some of them. For example, for products with profit sharing features, the cash flow projection may be done globally for several guarantees, but cash

flows are allocated at a later step (unbundled) for valuation purposes and even different contract boundaries may exist for contracts with different financial guarantees.

19. Dependencies at the level of premiums or reserves should also be considered to determine whether a contract should be unbundled. In particular, these dependencies may prevent a contract from being unbundled in case they create a discernible dependency in terms of insurance or financial risk.

20. In particular, in case of a product including two savings components where the policyholder decides the allocation of the premium or existing reserves between the two components or where this is predetermined (e.g. changing the percentage of each premium allocated to each component depending on the age of the policyholder). In this case, there is no connection between the risk of both savings components and this behaviour could be easily replicated with two independent products.

21. For example, in a contract with two parts, general account plus unit linked, where the policyholder may choose the percentage of premium allocated to each part, the dependency exists only at the level of the premium and 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.

22. However, in case there are dynamic reallocations (i.e. not controlled by the policyholder nor predefined), the risk between both parts is connected as the premium/reserve represents the risk exposure for savings products and the reallocations depend on the evolution of the financial risk. Therefore, dynamic reallocations usually prevent from unbundling.

23. In case of a combination of a savings product with a rider, if the premium for the rider is predefined (e.g. the undertaking cannot amend it), then there is no connection between the risks as the premium for the savings component can be determined beforehand. In case the premium for the mortality cover is not predefined (e.g. the undertaking can amend it), there is a dependency from the savings component on the rider, i.e. if the mortality risk changes, this would impact the savings component. Therefore, in this case unbundling would not be possible provided this dependency has a discernible effect on the economics of the contract.

24. Similarly, when the rider is covered through periodical charges from the savings component, the product may still be unbundled in case these charges are predefined. It should be noted that if the product is not unbundled, these charges should be considered to be part of the benefits agreed within the contract. Conversely, in case the contract can be unbundled, both parts should be treated as independent contracts. This means that the periodical

charges should be considered to be equivalent to premiums that should be projected only within contract boundaries.

25. For example, a whole life unit-linked product with a rider (e.g. mortality cover) that has a single premium paid at the beginning of the contract were costs are deducted periodically from the market value of the fund to cover the rider. In this case, if the contract cannot be unbundled, the periodical charges should not be considered to be equivalent to premiums so they are to be projected regardless of contract boundaries.

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.

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.

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.

Explanatory text

26. 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. Other alternative approaches could be based on previous quantitative assessments or quantitative assessments performed for similar products. This means that new business is expected to rely on a past quantitative analysis for the same product if available, notwithstanding the potential need, at some point in time, to repeat the assessment based on Guideline 6c.

27. The quantitative assessment should be based on all future obligations related to the contract, including expenses, as guarantees on the level of expenses may have a discernible effect on the economics of the contract. This means that the calculation 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. For example, for a 10 year contract offering an financial guarantee of benefits revised annually with a minimum of 0%, the assessment whether the 0% minimum guarantee provides a discernible effect should consider all premiums and the related obligations within the contractual period (10 years) regardless whether in the end the final conclusion is that contract boundaries are shorter.

28. In order 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.

29. 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 a higher level.

30. In some cases the outcome of the quantitative assessment will require additional considerations. For example, an undertaking may determine that for a specific product in

case the stochastic value of the financial guarantee over the value of all future obligations is only 0.5%, the financial guarantee does not have a discernible effect on the economics of the contract, but if the ratio were 2% it would be considered to have a discernible effect on the economics of the contract. However, in some cases (e.g. 1%, which falls within the range 0.5% - 2%) 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. In any case, undertakings are expected to use recommendations by NSAs, or in case of no recommendations, set their own ranges after consulting NSAs, which may be wider or narrower depending on the contract under assessment. It should also be noted that the value of the financial guarantee using deterministic valuation will usually be lower than its stochastic value.

31. 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.

32. For the purpose of this assessment, the expected payments linked to future discretionary benefits whose allocation is absolutely voluntary for the undertaking should not be considered as 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. Any other future discretionary benefit should be considered in the 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

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.

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

33. 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. Other alternative approaches could be based on previous quantitative assessments or quantitative assessments performed for similar products. This means that new business is expected to rely on a past quantitative analysis for the same product if available, notwithstanding the potential need, at some point in time, to repeat the assessment based on Guideline 6c.

34. The quantitative assessment should be based on all future obligations related to the contract, including expenses. This means that the calculation 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.

35. 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.

36. 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 a higher level.

37. In some cases the outcome of the quantitative assessment will require additional considerations. For example, an undertaking may determine that for a specific product in case the value of the cover over the value of all future obligations is only 0.5%, the cover does not have a discernible effect on the economics of the contract, but if the ratio were 2% it would be considered to have a discernible effect on the economics of the contract. However, in some cases (e.g. 1%, which falls within the range 0.5% - 2%) 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. In any case, undertakings are expected to use recommendations by NSAs, or in case of no recommendations, set their own ranges after consulting NSAs, which may be wider or narrower depending on the contract under assessment.

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 as well as changes in the terms of the contract, contract boundaries may need to be amended.

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.

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.

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.

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.

Explanatory text

38. 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.

39. 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.

40. Changes in the economic environment should only lead to a reassessment when they are extreme, i.e. the probability of changing back to the original situation in the mid-term is low. Changes in the relevant risk-free rate since the date when the assessment used to define the current contract boundaries was performed that are lower than the interest rate stress in the Standard Formula should not be considered to be extreme. This does not necessarily mean that any change in the risk-free rate term structure beyond the interest rate stress in the Standard Formula should be considered to be extreme.

41. To determine whether the change in the risk-free rate is extreme or not, undertakings may use simplified indicators as long as they suit the nature and risk of the relevant obligations. For example, undertakings may base the assessment on the term of the risk-free rate term structure that matches the current Macaulay duration of the relevant obligations. If the difference between the current value of the term and its value when the last assessment was performed is lower than the interest rate stress of the Standard Formula for that term, the change in the risk-free rate term structure would not be considered to be extreme.

42. The outcome of a quantitative assessment has clearly changed only in case there has been a material change in the ratio compared to the outcome at when the assessment used to define the current contract boundaries was performed. Following the example in paragraph 19.5 or 24.5, if the undertaking concluded at inception that a ratio of 1.5% in that particular case does not create a discernible effect on the economics of the contract, the undertaking is not expected to change contract boundaries in case a reassessment leads to a 2% ratio, as it does not lead to clearly different conclusion compared to the previous assessment.

43. The point in time when the reassessment is performed may have an impact on the outcome, regardless of the economic conditions (e.g. assessment performed at inception vs. reassessment performed at year t). If undertakings do not properly consider this effect, the possibility to conclude that there is no discernible effect might increase with time for some contracts. One alternative to overcome this effect is to perform the reassessment as if the contracts were issued at valuation date or base the reassessment for existing contracts on the assessment for similar new contracts.

44. 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. 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.

45. 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.

46. 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.

Guideline 7 - Estimation of obligations

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.

Undertakings should revise this estimated assessment as soon as more detailed information is available.

Explanatory text

47. A need to reassess the contract boundaries can arise, where a delegated underwriting authority or binder exists which can sign business on behalf of the undertaking. The undertaking requires information on the underlying insurance contracts written within the binder to assess the contracts which fall within the contract boundary at a given valuation date. If this information is not available, estimates will need to be made.

48. Estimates of contracts entered into can be based on historical experience of specific binders in terms of numbers of contracts likely to be entered into and their terms and conditions and hence the length of their contract boundaries and likely corresponding cash-flows.

49. The undertaking would aim to minimise any delay in receiving detailed information from the binder and would make a revised assessment of the contracts entered into and their corresponding contract boundaries as soon as reasonable after this information was received.

50. In the situation that updated exposure information becomes available after the signature of the contract (e.g. because the underlying exposure changes in the case of some liability contracts or underlying exposure is unknown at the time of signing for contracts covering voyages undertaken in a certain time period) one would not expect this to lead to a change

in the contract boundary. If, however, this analysis leads to a change in contract boundary, the contract boundary would be updated.

Guideline 8 - Reinsurance contracts

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.

Explanatory text

51. The boundary of a reinsurance contract may be different in the Solvency II balance sheet of the buyer of the reinsurance when compared to the Solvency II balance sheet of the seller of the reinsurance.

Compliance and Reporting Rules

52. 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.
53. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.
54. 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.
55. 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

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