CONSULTATION PAPER ON THE ANNEX TO THE OPINION ON THE USE OF RISK MITIGATION TECHNIQUES BY INSURANCE UNDERTAKINGS: PROPORTIONAL REINSURANCE WITH FEATURES REDUCING COMMENSURATENESS

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RESPONDING TO THIS PAPER

EIOPA welcomes comments on the consultation paper on a new annex to the opinion on the use of risk mitigation techniques by insurance undertakings: Proportional reinsurance with features reducing commensurateness.

Comments are most helpful if they:

- respond to the question stated, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA by 17 July 2026, 23:59 CET responding to the questions in the survey provided at the following link:

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

Contributions not provided using the survey or submitted after the deadline will not be processed. In case you have any questions please use the contact form for the survey (link above).

Publication of responses

Your responses will be published on the EIOPA website unless: you request to treat them confidential, or they are unlawful, or they would infringe the rights of any third party. Please, indicate clearly and prominently in your submission any part you do not wish to be publicly disclosed. EIOPA may also publish a summary of the survey input received on its website.

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1. LEGAL BASIS

1.1. The European Insurance and Occupational Pensions Authority (EIOPA) issued the Opinion on the use of risk mitigation techniques by insurance undertakings on the basis of Article 29(2) of Regulation (EU) No 1094/2010[2]. This Article mandates EIOPA to play an active role in building a common Union supervisory culture and consistent supervisory practices, as well as in ensuring uniform procedures and consistent approaches throughout the Union.

1.2. EIOPA provides this Annex to the Opinion on the use of risk mitigation techniques by insurance undertakings on the basis of Directive 2009/138/EC (Solvency II Directive)[3], in particular Articles 134(1), 172(3) and 173 thereof and Commission Delegated Regulation (EU) 2015/35 (Solvency II Delegated Regulation)[4], in particular Articles 211(2)(b) and (c), 213 and 214 thereof.

1.3. The Board of Supervisors has amended the above-mentioned Opinion by adding this Annex in accordance with Article 2(8) of its Rules of Procedure[5].

2. CONTEXT AND OBJECTIVE

2.1. Reinsurance is an important tool for capital and risk management, used also for risk diversification, access to additional underwriting capacity for portfolio expansion, addressing the protection gaps and increasing financial stability. It plays a crucial role in the insurance industry's ability to operate and provide coverage to individuals and businesses.

2.2. The transition to a risk-based regime led to an increased use non-traditional risk mitigation techniques, i.e., risk mitigation techniques not frequently used in the past in the European insurance market. Consequently, EIOPA published in July 2021 its Opinion on the use of risk mitigation techniques by insurance undertakings[6] providing guidance on the assessment of risk mitigation techniques, in particular regarding the consistency between the Solvency Capital Requirement (SCR) and risk transfer. Where the use of reinsurance would lead to a reduction in the SCR that is not commensurate with the extent of the risk transferred or

2 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 Pensions 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 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 (OJ L 335, 17.12.2009, p. 1-155).

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. 1–797).

5 Decision adopting the Rules of Procedure of EIOPA's Board of Supervisors, available at: https://www.eiopa.europa.eu/system/files/2022-07/bos-rules_of_procedure.pdf

6 https://www.eiopa.europa.eu/publications/opinion-use-risk-mitigation-techniques-insurance-undertakings_en

due to an inappropriate treatment within the SCR of any new risks that are acquired in the process, insurance and reinsurance undertakings should conclude that the risk-mitigating technique does not provide an effective transfer of risk.

2.3. This Annex aims to detail the guidance provided in the Opinion for the case of proportional reinsurance with features reducing commensurateness as, for example, variable commissions, loss corridors or loss limits. Closely related to this topic, this Annex also clarifies the treatment of reinsurance commissions under the Standard Formula's premium risk, currently addressed by Q&A 1898[7].

2.4. It should be noted that, in any case, insurance and reinsurance undertakings are expected to include this type of features in their reinsurance treaties if it is in line with the risk-management policy, i.e., the Annex only addresses the impact that these features may have on the effectiveness of the risk transfer in the context of Article 210 of the Solvency II Delegated Regulation.

[7] 1898 - European Insurance and Occupational Pensions Authority

3. PROPORTIONAL REINSURANCE WITH FEATURES REDUCING COMMENSURATENESS

3.1. DESCRIPTION OF THE CASE

3.1. The premium and reserve risk of the non-life underwriting risk and health Non-Similar-to-Life-Techniques (NSLT) risk modules of the Standard Formula follows a formula-based approach based on a volume measure, which is derived from the net premiums and net best estimate liability of the insurance undertakings. This approach aims to accurately captures the risk mitigating effect of proportional reinsurance treaties by assuming that the reduction on the volume measure is proportional to the risk transfer achieved.

3.2. Under proportional reinsurance, the cession percentage (risk transfer) for each risk is based on the respective sum insured against the limits of the reinsurance treaty. This percentage is then applied to occurred losses since the first euro amount. Conversely, on non-proportional reinsurance, the cession basis, within the treaty limits, relies on the occurred losses above a certain threshold - deductible -, which is defined on a per risk, per event or on an aggregate basis, depending on the type of treaty in presence.

3.3. However, some reinsurance agreements are “stretching” some features, which may disrupt the nature of the pure proportional reinsurance and, at times, generate (hybrid) structures which may materially interfere on risk transfer reducing commensurateness.

3.4. The referred features, as for example variable commissions (e.g., sliding-scale commissions or profit commissions), loss corridors or loss limits, significantly limit the amount of risk transferred and may jeopardize commensurateness, i.e. the balance between risk transfer and capital release under the Standard Formula. For example, a 60% quota-share reinsurance treaty with a loss cap at 80% will have the same recoverables associated to the claims best estimate liability than a 60% quota-share reinsurance treaty without a loss cap if the loss-ratio is below 80%. However, the risk transfer of the treaty with the loss cap is lower.

3.5. Variable commissions may also achieve a similar effect: the progressive decrease of the commission (partially) offsets the increasing payment by the reinsurer for its share of the claim within the range where commissions are variable, which might represent a material reduction of the risk transfer.

3.2. ASSESSING THE BALANCE BETWEEN RISK TRANSFER AND CAPITAL RELEASE

3.6. Recognition of risk mitigation techniques for the calculation of the SCR using the Standard Formula is regulated in Articles 208-214 of the Solvency II Delegated Regulation. Article 210 requires an effective transfer of risk that does not result in material basis risk or in the creation of other risks, unless this is reflected in the calculation of the SCR.

3.7. According to EIOPA's Opinion on the use of risk mitigation techniques[8], an effective risk transfer in the sense of Article 210 of the Solvency II Delegated Regulation also must be commensurate to the capital release. Therefore:

Within the assessment performed by the actuarial function on the adequacy of material proportional reinsurance arrangements, insurance undertakings are expected to assess whether features reducing commensurateness breach the commensurateness between risk transfer and capital release that usually exists in proportional reinsurance treaties. If commensurateness is jeopardized, the risk-mitigating effect of the reinsurance treaty should not be recognised in the Standard Formula.

In addition, insurance undertakings are expected to include in the ORSA an assessment of the deviations of their risk profile from the assumption underlying the Standard Formula according to Article 45(1)(2) of the Solvency II Directive including the impact of features reducing commensurateness on proportional reinsurance treaties.

Following the proportionality principle, the previous approach may not be applied when the impact on the non-life (or health NSLT) SCR is not material, so insurance undertakings may directly consider the risk-mitigating effect of the reinsurance treaty. In any case, insurance undertakings should ensure that commensurateness is still observed when considering all risk-mitigating techniques together. Materiality should be evaluated according to objective criteria consistently across contracts and time.

3.8. There are several factors that influence the commensurateness of the risk transfer and should be considered for this assessment. For example, in case of proportional reinsurance treaties including variable commissions, commensurateness between the risk transfer and the capital release may be at risk depending on the level, range and steepness of the commissions' staircase applied. In essence, changes in the amount of variable commissions (partially or even fully) offset the changes in the amount of claims reducing the risk transfer.

[8] Opinion on the use of risk mitigation techniques

Similarly, the width and starting point of loss corridors as well as the distance between the loss cap and the expected loss-ratio of the treaty are expected to influence the assessment.

3.9. However, the commensurateness of the risk transfer should be assessed on a case-by-case basis as it depends on the undertaking's expected losses, the risk profile, the characteristics of the features reducing commensurateness and the interaction between different reinsurance arrangements covering the same risk.

3.10. To assess commensurateness, different quantitative approaches may be used.

3.11. For example, **Monte-Carlo simulations** allow comparing the risk-mitigating effect with the capital release under the Standard Formula. To measure the real risk-mitigating effect, a simple alternative could be running Monte-Carlo simulations relying on Standard Formula assumptions, i.e., lognormality and the standard deviations of each LoB provided in the Solvency II Delegated Regulation. Undertakings might use different assumptions that better fit their risk profile.

3.12. Another example is the **Expected Reinsurance Deficit (ERD)**[9], which is a method frequently used to determine whether there is actual risk transfer. While it is not directly assessing commensurateness, comparing the result of the ERD test for the real treaty with the result of the ERD test for a plain proportional reinsurance treaty[10] can provide relevant insight, as a lower result means that the expected loss per euro of premium is lower than for a plain proportional reinsurance treaty. As net premiums are the volume measure for the premium risk, a lower expected loss per euro of premium indicates a lower risk transfer per euro of capital release. A material difference would therefore be evidence of lack of commensurateness.

3.13. It is important to notice that high values in the ERD test alone (e.g. 5%), do not automatically (or in all cases) imply commensurateness. Similarly, low values in the ERD alone (e.g., below the 10-10 rule, 1%) do not automatically (or in all cases) mean lack of commensurateness, as low ERD values may result for certain catastrophic risks, which are highly sensitive to the vendor model used and/or have limited data history.

3.14. In any case, the conclusion on material basis risk and commensurateness should not only result from a quantitative, but also from a qualitative analysis.

3.15. It should be noted that insurance undertakings are not expected to perform quantitative tests for all proportional reinsurance treaties with features reducing commensurateness, as in several cases it might be possible to conclude following a qualitative assessment (e.g., in case of immaterial features). This quantitative assessment is expected in cases where

[9] ERD = P(loss) * E (Severity|loss) / Reinsurance premium

- P(loss) = Probability that the reinsurer incurs losses
- E(Severity|loss) = Expected loss given that a loss occurs
- Reinsurance premium = premium ceded to the reinsurer net of reinsurance commissions.

[10] I.e., a proportional reinsurance treaty without any feature reducing commensurateness.

insurance undertakings or supervisory authorities have doubts about the commensurateness of a specific reinsurance treaty.

4. COMMISSIONS IN THE VOLUME MEASURE FOR NON-LIFE PREMIUM RISK (Q&A 1898)

4.1. Following the considerations and principles presented in the sections above, one related question is whether commissions paid by the reinsurer to the cedant should increase the volume measure of premium risk in the non-life underwriting risk (or health NSLT risk) in the Standard Formula of the cedant. EIOPA's Q&A 1898[11] addresses this topic for commissions, although – according to EIOPA's information - it has not been consistently interpreted, leading to different approaches.

4.2. Premium risk in the non-life (and health NSLT) underwriting risk covers the volatility of claims and expenses. Therefore, the volume measure for premium risk is expected to capture all material exposures to relevant risks, including expense risk.

4.3. Fixed reinsurance commissions frequently represent exposure to risk for the cedent. For example, in case expense risk is not transferred through a proportional reinsurance treaty, reinsurers pay back the part of the proportional premium ceded that covers the expenses of the cedent, i.e., it mostly represents the cedent's exposure to expense risk. In such a case fixed reinsurance commissions should be considered to be part of the premium representing exposure to expense risk borne by the cedent and, therefore, should increase the volume measure.

4.4. Variable commissions usually depend on the loss ratio or profits of the cedent and, therefore, usually do not interact with the size or volume measure of a risk exposure for the cedent. Instead, they interact with the distribution of net losses, e.g., reducing risk transfer around the expected loss ratio and keeping it intact on the tail. Therefore, variable commissions may not lead to any adjustment of the volume measure but instead, as discussed in the previous section, they may jeopardize commensurateness between the risk transfer and the capital release.

4.5. However, case by case analysis is needed as variable commissions may still include some elements representing exposure to risk for the cedent that should be considered in the volume measure. For example, high minimum commissions of variable reinsurance commissions might replace a fixed reinsurance commission representing a material exposure to expense risk for the cedent so, in addition to the commensurateness assessment, an adjustment to the volume measure may be necessary.

[11] 1898 - European Insurance and Occupational Pensions Authority

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