Revised Guidelines on Valuation of Technical Provisions

European Insurance and Occupational Pensions Authority

Guideline 0 – Proportionality (New Guideline)

1. Insurance and reinsurance undertakings should apply the Guidelines on valuation of technical provisions in a manner that is proportionate to the nature, scale and complexity of the risks inherent in their business. This should not result in a material deviation of the value of the technical from the current amount that insurance and reinsurance undertakings would have to pay if they were to transfer their insurance and reinsurance obligations immediately to another insurance or reinsurance undertaking

Guideline 24A – Materiality in assumptions setting (New Guideline)

2. Insurance and reinsurance undertakings should set assumptions and use expert judgment, in particular taking into account the materiality of the impact of the use of assumptions with respect to the following Guidelines on assumption setting and expert judgement.
3. Insurance and reinsurance undertakings should assess materiality taking into account both quantitative and qualitative indicators and taking into consideration binary events, extreme events, and events that are not present in historical data. Insurance and reinsurance undertakings should overall evaluate the indicators considered.

Guideline 24B – Governance of Assumptions setting (New Guideline)

4. Insurance and reinsurance undertakings should ensure that all assumption setting and the use of expert judgement in particular, follows a validated and documented process.
5. Insurance and reinsurance undertakings should ensure that the assumptions are derived and used consistently over time and across the insurance or reinsurance undertaking and that they are fit for their intended use.
6. Insurance and reinsurance undertakings should approve the assumptions at levels of sufficient seniority according to their materiality, for most material assumptions up to and including the administrative, management or supervisory body.

Guideline 24C – Communication and uncertainty in assumptions setting (New Guideline)

7. Insurance and reinsurance undertakings should ensure that the processes around assumptions, and in particular around the use of expert judgement in choosing those assumptions, specifically attempt to mitigate the risk of misunderstanding or miscommunication between all different roles related to such assumptions.
8. Insurance and reinsurance undertakings should establish a formal and documented feedback process between the providers and the users of material expert judgement and of the resulting assumptions.

9. Insurance and reinsurance undertakings should make transparent the uncertainty of the assumptions as well as the associated variation in final results.

Guideline 24D – Documentation of assumptions setting (New Guideline)

10. Insurance and reinsurance undertakings should document the assumption setting process and, in particular, the use of expert judgement, in such a manner that the process is transparent.
11. Insurance and reinsurance undertakings should include in the documentation the resulting assumptions and their materiality, the experts involved, the intended use and the period of validity.
12. Insurance and reinsurance undertakings should include the rationale for the opinion, including the information basis used, with the level of detail necessary to make transparent both the assumptions and the process and decision-making criteria used for the selection of the assumptions and disregarding other alternatives.
13. Insurance and reinsurance undertakings should make sure that users of material assumptions receive clear and comprehensive written information about those assumptions.

Guideline 24E – Validation of assumptions setting (New Guideline)

14. Insurance and reinsurance undertakings should ensure that the process for choosing assumptions and using expert judgement is validated.
15. Insurance and reinsurance undertakings should ensure that the process and the tools for validating the assumptions and in particular the use of expert judgement are documented.
16. Insurance and reinsurance undertakings should track the changes of material assumptions in response to new information, and analyse and explain those changes as well as deviations of realisations from material assumptions.
17. Insurance and reinsurance undertakings, where feasible and appropriate, should use validation tools such as stress testing or sensitivity testing.
18. Insurance and reinsurance undertakings should review the assumptions chosen, relying on independent internal or external expertise.
19. Insurance and reinsurance undertakings should detect the occurrence of circumstances under which the assumptions would be considered false.

Guideline 25 – Modelling biometric risk factors (Amended Guideline)

20. Insurance and reinsurance undertakings should consider whether a deterministic or a stochastic approach is proportionate to model the uncertainty of biometric risk factors.

21. Insurance and reinsurance undertakings should take into account the duration of the liabilities when assessing whether a method that neglects expected future changes in biometrical risk factors is proportionate, in particular in assessing the error introduced in the result by the method.
22. Insurance and reinsurance undertakings should ensure, when assessing whether a method that assumes that biometric risk factors are independent from any other variable is proportionate, and that the specificities of the risk factors are taken into account. For this purpose, the assessment of the level of correlation should be based on historical data and expert judgment.

Guideline 28A – Investment Management Expenses (New Guideline)

23. Insurance and reinsurance undertakings should include in the best estimate administrative and trading expenses associated with the investments needed to service insurance and reinsurance contracts.
24. In particular, for products whose terms and conditions of the contract or the regulation requires to identify the investments associated with a product (e.g. most unit linked and index linked products, products managed in ring-fenced funds and products to which matching adjustment is applied), insurance and reinsurance undertakings should consider the investments.
25. For other products, insurance and reinsurance undertakings should base the assessment on the characteristics of the contracts.
26. As a simplification, insurance and reinsurance undertakings may also consider all investment management expenses.
27. Reimbursements of investment management expenses that the fund manager pays to the undertaking should be taken into account as other incoming cash flows. Where these reimbursements are shared with the policyholders or other third parties, the corresponding cash out flows should also be considered.

Guideline 30 – Apportionement of Expenses (Amended Guideline)

28. Insurance and reinsurance undertakings should allocate and project expenses in a realistic and objective manner and should base the allocation of these expenses on their long-term business strategies, on recent analyses of the operations of the business, on the identification of appropriate expense drivers and on relevant expense apportionment ratios.
29. Without prejudice to the proportionality assessment and the first paragraph of this guideline, insurance and reinsurance undertakings should consider using, in order to allocate overhead expenses over time, the simplification outlined in Technical Annex I, when the following conditions are met:

a) the undertaking pursues annually renewable business;
b) the renewals must be reputed to be new business according the boundaries of the insurance contract;
c) the claims occur uniformly during the coverage period.

Guideline 33 – Changes in expenses (Amended Guideline)

30. Insurance and reinsurance undertakings should ensure that assumptions with respect to the evolution of expenses over time, including future expenses arising from commitments made on or prior to the valuation date, are appropriate and consider the nature of the expenses involved. Insurance and reinsurance undertakings should make an allowance for inflation that is consistent with the economic assumptions made and with dependency of expenses on other cash flows of the contract.

Guideline 37A – Dynamic policyholder behaviour (New Guideline)

31. Insurance and reinsurance undertakings should base their assumptions on the exercise rate of relevant options on:
    - statistical and empirical evidence, where it is representative of future conduct, and
    - expert judgment on sound rationale and with clear documentation.
32. The lack of data for extreme scenarios should not be considered alone to be a reason to avoid dynamic policyholder behaviour modelling and/or the interaction with future management actions.

Guideline 37B – Bidirectional assumptions (New Guideline)

33. When setting the assumptions on dynamic policyholder behaviour, insurance and reinsurance undertakings should consider that the dependency on the trigger event and the exercise rate of the option is usually bidirectional, i.e. both an increase and a decrease should be considered depending on the direction of the trigger event.

Guideline 37C – Option to pay additional or different premiums (New Guideline)

34. Insurance and reinsurance undertakings should model all relevant contractual options when projecting the cash flows, including the option to pay additional premiums or to vary the amount of premiums to be paid that fall within contract boundaries.

Guideline 40A – Comprehensive management plan (New Guideline)

35. Insurance and reinsurance undertakings should ensure that the comprehensive future management actions plan that is approved by the administrative, management or supervisory body is either:

- a single document listing all assumptions relating to future management actions used in the best estimate calculation; or
- a set of documents, accompanied by an inventory, that clearly provide a complete view of all assumptions relating to future management actions used in best estimate calculation.

Guideline 40B – Consideration of new business in setting future management actions (New Guideline)

36. Insurance and reinsurance undertakings should consider the effect of new business in setting future management actions and duly consider the consequences on other related assumptions. In particular, the fact that the set of cash-flows to be projected through the application of Article 18 of the Delegated Regulation on contract boundaries is limited should not lead insurance and reinsurance undertakings to consider that assumptions only rely on this projected set of cash-flows without any influence of new business. This is particularly the case for assumptions on the allocation of risky assets, management of the duration gap or application of profit sharing mechanisms.

Guideline 53A – Use of stochastic valuation (New Guideline)

37. Insurance and reinsurance undertakings should use stochastic modelling for the valuation of technical provisions of contracts whose cash flows depend on future events and developments, in particular those with material options and guarantees.
38. When assessing whether stochastic modelling is needed to adequately capture the value of options and guarantees, insurance and reinsurance undertakings should, in particular but not only, consider the following cases:
    - any kind of profit-sharing mechanism where the future benefits depend on the return of the assets;
    - financial guarantees (e.g. technical rates, even without profit sharing mechanism), in particular, but not only, where combined with options (e.g. surrender options) whose dynamic modelling would increase the present value of cash flows in some scenarios.

Guideline 57A – Market risk factors needed to deliver appropriate results (New Guideline)

39. When assessing whether all the relevant risk factors are modelled with respect to the provisions of Articles 22(3) and 34(5) of the Delegated Regulation, insurance and reinsurance undertakings should be able to demonstrate that their modelling adequately reflects the volatility of their assets and that the material sources of volatility are appropriately reflected (e.g. spreads and default risk).
40. In particular, insurance and reinsurance undertakings should use models that allow for the modelling of negative interest rates.

Guideline 77 – Assumptions used to calculate EPIFP (Amended Guideline)

41. For the purpose of calculating the technical provisions without risk margin under the assumption that the premiums relating to existing insurance and reinsurance contracts that are expected to be received in the future are not received, insurance and reinsurance undertakings should apply the same actuarial method used to calculate the technical provisions without risk margin in accordance with Article 77 of the Solvency II Directive, with the following changed assumptions:
    a) policies should be treated as though they continue to be in force rather than being considered as surrendered;
    b) regardless of the legal or contractual terms applicable to the contract, the calculation should not include penalties, reductions or any other type of adjustment to the theoretical actuarial valuation of technical provisions without a risk margin calculated as though the policy continued to be in force.
42. All the other assumptions (e.g. mortality, lapses or expenses) should remain unchanged. This means that the insurance and reinsurance undertakings should apply the same projection horizon, future management actions and policyholder option exercise rates used in best estimate calculation without adjusting them to consider that future premiums will not be received. Even if all assumptions on expenses should remain constant, the level of some expenses (e.g. acquisition expenses or investment management expenses) could be indirectly affected.

Guideline 77A – Alternative approach to calculate to calculate EPIFP (New Guideline)

43. Insurance and reinsurance undertakings may identify EPIFP as the part of present value of future profits related to future premiums in case the outcome does not materially deviate from the value that would have resulted from the valuation described in Guideline 77. This approach may be implemented using a formula design.

Compliance and Reporting Rules

44. 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.

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

46. 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.

47. 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

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