

**CONSULTATION PAPER ON THE  
ANNEXES TO THE OPINION ON  
THE USE OF RISK MITIGATION  
TECHNIQUES BY INSURANCE  
UNDERTAKINGS: MASS-LAPSE  
REINSURANCE AND  
REINSURANCE AGREEMENTS'  
TERMINATION CLAUSES**

EIOPA-BoS-24/419  
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**eiopa**

European Insurance and  
Occupational Pensions Authority

## RESPONDING TO THIS PAPER

EIOPA welcomes comments on the consultation paper on two annexes to the opinion on the use of risk mitigation techniques by insurance undertakings: Mass-lapse reinsurance and reinsurance agreements' termination clauses.

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 Friday 7 February 2025, 23:59 CET responding to the questions in the survey provided at the following link:

<https://ec.europa.eu/eusurvey/runner/AnnexesOptinionRMT>

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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#### **Data protection**

Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published. EIOPA, as a European Authority, will process any personal data in line with Regulation (EU) 2018/1725. More information on how personal data are treated can be found in the privacy statement at the end of the public consultation document.

## 1. LEGAL BASIS

- 1.1. The European Insurance and Occupational Pensions Authority (EIOPA) provides these Annexes to 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<sup>2</sup>. 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 delivers these Annexes to the Opinion on the use of risk mitigation techniques by insurance undertakings on the basis of Directive 2009/138/EC (Solvency II Directive)<sup>3</sup>, in particular Articles 134(1), 172(3) and 173 thereof and Commission Delegated Regulation (EU) 2015/35 (Solvency II Delegated Regulation)<sup>4</sup>, in particular Articles 211(2)(b) and (c), 213 and 214 thereof.  
These Annexes are addressed to the competent authorities, as defined in Article 4(2) of Regulation (EU) No 1094/2010<sup>5</sup> and shall be applied considering proportionality and following a risk based approach.
- 1.3. The Board of Supervisors has adopted these Annexes to the above mentioned Opinion in accordance with Article 2(8) of its Rules of Procedure<sup>6</sup>.

## 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 the 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 increase of the 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

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<sup>2</sup> 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).

<sup>3</sup> 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).

<sup>4</sup> 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).

<sup>6</sup> 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](https://www.eiopa.europa.eu/system/files/2022-07/bos-rules_of_procedure.pdf)

use of risk mitigation techniques by insurance undertakings<sup>7</sup> providing guidance on the assessment of risk mitigation techniques, in particular regarding the consistency between 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 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. These Annexes aim to extend the guidance provided in the Opinion reflecting on its application to two specific cases mass-lapse reinsurance and reinsurance agreements' termination clauses. To ensure a comprehensive overview, the first Annex will discuss the main elements of mass-lapse reinsurance treaties, addressing Solvency II Standard Formula SCR calculation, cedant and reinsurer perspective, reinsurance recoverables valuation and risk-margin calculation. The second Annex discusses terms of reinsurance treaties related to termination clauses that compromise the effective transfer of risk for the purposes of SCR calculation.

**Question to stakeholders 1**

Do stakeholders see the need for detailed guidance on mass-lapse reinsurance and-or for other reinsurance structures or clauses?

- No
- Yes
- Yes, but less detailed / more high-level

If yes, which reinsurance structures and why?

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<sup>7</sup> [https://www.eiopa.europa.eu/publications/opinion-use-risk-mitigation-techniques-insurance-undertakings\\_en](https://www.eiopa.europa.eu/publications/opinion-use-risk-mitigation-techniques-insurance-undertakings_en)

## 3. MASS-LAPSE REINSURANCE ANNEX

### 3.1. DESCRIPTION OF THE CASE

- 3.1. The lapse risk in the Solvency II Directive (Art. 105 (3) (f)) is defined as part of the life underwriting risk in the standard formula as the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level or volatility of the policyholders' lapse rates. While this lapse risk at the level of the Delegated Regulation (hereinafter, DR) is also covering health and non-life business, mass-lapse reinsurance is usually seen as mainly relevant risk for life business. Reasons are inter alia that, on the one hand the contract boundaries are often short for non-life, and on the other hand that the mass lapse scenario of the Standard Formula for life leads often to a substantial capital requirement, that is also sensitive to interest rates. Consequently, this analysis is therefore focused on life lapse risk, even if most considerations might be equally applicable for non-life and health business.
- 3.2. Lapses are considered for best estimate valuation purposes and depend on policyholder behaviour, which should consider the influence of all relevant factors according to Article 26 DR. Therefore, lapse risk in Solvency II also depends on these factors, which even may reinforce each other<sup>8</sup>. It has been pointed out that the ceteris-paribus approach of the Standard Formula where one risk factor is changed at a time, does not capture this kind of dependencies.
- 3.3. The standard formula capital requirement for lapse risk in all its manifestations is defined in the life-underwriting risk module according to Article 142 of the DR as the maximum of three scenario-based capital requirements: a permanent increase of lapse rates, a permanent decrease of lapse rates and for mass lapse as combination of instantaneous events. Solvency II requires insurance and reinsurance undertakings to apply a 40% stress for mass lapse risk (70% for management of group pension funds, referred to with Article 2(3)(b)(iii) and (iv) of the Solvency II Directive). In many cases (e.g., when risk-free interest rates are higher than guaranteed rates), the mass lapse scenario is dominant among these three scenarios.
- 3.4. In the development of the Standard Formula, the mass lapse scenario was included by CEIOPS to capture non-permanent changes to the lapse rates<sup>9</sup>:

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<sup>8</sup> CEIOPS' Advice for Level 2 Implementing Measures on Solvency II: Standard formula SCR - Article 109 c Life underwriting risk [CEIOPS-DOC-42-09-L2-Advice-Standard-Formula-Life-underwriting-risk \(europa.eu\)](#)

<sup>9</sup> CEIOPS' Advice for Level 2 Implementing Measures on Solvency II: Standard formula SCR - Article 109 c Life underwriting risk [CEIOPS-DOC-42-09-L2-Advice-Standard-Formula-Life-underwriting-risk \(europa.eu\)](#)

“The scenario shocks lapse-shock-up and lapse-shock-down cover the risk of a misestimation or of a permanent change of lapse rates. By contrast, the mass lapse event covers the risk of a temporary and drastic rise of lapse rates. The likeliness that policyholders terminate their policies is increased for a limited span of time.”

- 3.5. The mass-lapse event stands for all non-structural changes in lapse rates. In practice, lapses triggered by an event can manifest over a longer period than a year, for example, due to the lag in the reaction of policyholders. Especially if the lapses are a reaction to a 1 in 200 event, some lapses may not occur within the next 12 months.
- 3.6. Mass-lapse reinsurance (MLR) in this note is understood as a non-proportional reinsurance treaty designed to cover part of this scenario, usually defining an attachment point (e.g., 15% lapse rate over assumed best estimate lapse rates) and a detachment point, usually based on the stress set out in Article 142 (6) (b) DR, i.e., 40% lapse rate over assumed best estimate lapse rates. In a straightforward example, a MLR treaty covers all the losses associated to an excess of lapses between 15% and 40% over assumed best estimate lapse rates.

## 3.2. FEEDBACK REQUEST

- 3.7. When assessing MLR treaties, the distribution of mass-lapse losses and the probability of mass lapse events that last for or manifest over more than one year (“multi-year mass-lapse events”, cf. par. 3.5) should be considered. For example if 40% of the policyholders surrender their contracts through a 2-year period (e.g., 20% in one year and 20% in the second year).
- 3.8. For such an event, the key element is the length of the measurement period, which should not be confused with the duration of the treaty. The duration or maturity of the treaty represents the contractual term of the MLR treaty. Based on the contracts seen so far, the duration is frequently higher than 12 months (e.g., 2 or 3 years). The measurement period, also known as cover period or risk window, represents the period for which the lapses are aggregated to determine the amount of the claim. For example, a contract may have a 3-year duration and 12-month measurement periods. Under this contract, all the lapses within the first 12 months would be added to assess whether they exceed the attachment point and a claim exists under the MLR treaty. For each new measurement period the accumulation is “reset”, and the next measurement period starts. The contract would be over after 3 years, i.e., at the end of the last measurement period.
- 3.9. If a MLR treaty aggregates claims for a 12-month measurement period, it might not absorb losses arising from multi-year mass-lapse events, as these events span through longer periods and the lapses within the first 12 months may not be high enough to trigger the MLR treaty. For example, a MLR treaty with an attachment point of 20% over assumed best

estimate lapse rate and 12-month measurement periods would not be triggered by a mass-lapse event that lasts 2 years leading to 20% of lapses over assumed best estimate lapse rate each 12-month period. However, this treaty would significantly reduce the mass-lapse SCR. Therefore, an undertaking signing such MLR treaty may not have enough capital (set aside through the SCR) to absorb the losses from this 2-year mass-lapse event.

#### **Option 1: Measurement periods longer than 12 months**

- 3.10. It could be argued that MLR treaties with 12-month measurement periods create material basis risk as the cover provided by the MLR treaty would not mirror the losses of a multi-year mass-lapse event, which occurs within the 1-year time horizon, but materialises over a longer “limited period of time”. Therefore, the analysis of multi-year mass-lapse events should be included in the assessment of whether the risk transfer transaction complies with Articles 208 to 214 of the Delegated Regulation.
- 3.11. In other words, the MLR covers only one of the Standard Formula lapse scenarios and, while the Standard Formula in general is an appropriate simplification of lapse risk, the consideration of MLR tailored to one of the scenarios might endanger its appropriateness as other scenarios might not be covered by the MLR treaty, leading to the question whether the MLR treaty can be recognised as a risk mitigation technique in the SCR calculation.
- 3.12. A measurement period longer than 12 months (e.g., 24 months) for the MLR treaty would solve the issue ensuring that the own funds available are enough in case of mass-lapse events, improving the resilience of the insurance sector and policyholder protection.
- 3.13. This option would reduce the vulnerability of undertakings to multi-year mass-lapse events. However, EIOPA has not identified any MLR treaty with measurement periods longer than 12 months and the feedback received from some stakeholders indicates that the capacity of the reinsurance market to provide MLR with measurement periods longer than 12 months may be limited.

#### **Option 2: Measurement periods of at least 12 rolling months**

- 3.14. One could argue that Solvency II is based on the risk of loss within a 1-year time horizon and the concept of ‘mass-lapse’ refers an event consisting of a sudden but temporary increase of lapse rates, however without specifying any underlying event. and, secondly, this temporary increase of lapse rates should not be confused with the permanent increase of the lapses covered by the lapse up risk-module. Therefore, this event is bound to the 1-year time horizon, i.e., the increase in lapses lasts a maximum of 12 months.
- 3.15. Under Option 2, undertakings would be more vulnerable to multi-year mass-lapse events. However, one could argue that a similar level of protection could be achieved if MLR treaties are properly designed according to the guidance provided in this annex, in



particular through a combination of the right attachment point, long duration and rolling measurement periods<sup>10</sup>.

- 3.16. Longer-term stresses, as a multi-year mass-lapse events, should be analysed in detail in the ORSA, not only but especially when undertakings enter into a MLR treaty. In addition, it should be noted that the best estimate shall be based upon up-to-date information<sup>11</sup> and, consequently, undertakings will also eventually update best estimate lapse assumptions during an on-going multi-year mass-lapse event capturing its full expected impact in advance.

**Question to stakeholders 2**

**2.1.** Would any of the options have any impact in your case? Please briefly describe the reasons why.

**2.2.** Which additional pros, cons or additional considerations (if any) would you like to highlight for one or both options?

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<sup>10</sup> Rolling measurement periods overlap to ensure that at any point in time there are almost 12 months of cover pending in one measurement period. For example, each quarter a new 12-measurement period starts. This means that, in the example, a quarter is included within four different measurement periods, but MLR treaties include adjustment mechanisms to avoid paying several times for the same claim.

<sup>11</sup> Article 77(2) of the Solvency II Directive

### 3.3. SCR TREATMENT

- ▶ Based on their own risk profile, undertakings should also be able to demonstrate that the treaty provides an effective risk-transfer without creating material basis risk. For that purpose undertakings should especially assess whether the cover of the MLR treaty closely mirrors the changes in the value of the risk exposure under a comprehensive set of risk scenarios that are consistent with the confidence level set out in Article 101(3) of the Solvency II Directive, including structural changes in the economic environment. The results of this assessment should be part of the regular supervisory reporting (cf. Articles 306 and 309 (5) (a) DR).

- 3.17. The potential for lapse risk exposure to change significantly depends on the specific risk profile of the insurance and reinsurance undertakings. This is influenced by a number of factors, including the business model, the distribution channel, the type of insurance liabilities and the type of customers. Undertakings willing to utilise MLR treaties should have in place a specific risk management assessment concerning surrenders and the discontinuance options that they are more exposed to according to their materiality.
- 3.18. Some clauses and other features of MLR treaties might reduce the risk-mitigating effect of the treaty or lead to material basis risk (see especially Articles 1 (25), 210 and 86 of the DR). Therefore, undertaking should assess whether the MLR treaty leads to a commensurate risk transfer and whether it creates material basis risk. When defining the comprehensive set of scenarios for the assessment, undertakings should include scenarios at 99.5% where the mass-lapse event is likely to but does not occur or where other financial risk factors changed (e.g., spread risk). The results of this assessment should be part of the regular supervisory reporting (cf. Articles 306 and 309 (5) (a) DR).
- 3.19. Undertakings should consider that the MLR treaty does not provide an effective risk transfer if the MLR treaty does not closely mirror the changes in the value of the risk exposure in any of these scenarios, i.e., if there are material differences on the risk mitigating capacity of the MLR treaty across the different scenarios. Materiality should be checked with the comprehensive set of scenarios, so no diversification effect due to other risks is considered (See also the Guidelines on Basis Risk, Explanatory Text).
- 3.20. This section analyses some of the most relevant elements of MLR treaties to consider when assessing whether the treaty provides an effective transfer of risk or creates material basis risk, as well as for the calculation of its risk-mitigating effect.
- 3.21. In any case, each MLR treaty must be assessed on its own. It is not possible to define one solution to fit all cases and insurance and reinsurance undertakings are expected to assess

the appropriateness of the standard formula to reflect their risk profile and to analyse the risks related to their own MLR treaties especially in their ORSA.

### 3.3.1. CLEAR AND INCONTROVERTIBLE TERMS AND CONDITIONS

- ▶ Undertakings signing MLR treaties as risk mitigation techniques should ensure that the terms and conditions of the MLR treaty, i.e. the contractual arrangements governing the MLR treaty, are clear and incontrovertible to avoid any legal risk, as a lack of clarity would compromise risk transfer effectiveness. Incomplete or unclear definitions of the claim would lead to limited and non-effective risk transfer. (Cf. Article 210 (1) DR).

### 3.3.2. LAPSE DEFINITION AND BASIS RISK

- ▶ MLR treaties with restrictive definitions of the discontinuances covered that do not clearly cover all the cases from article 1(14)<sup>12</sup> of the DR, including partial exercise of any of the options create basis risk. Undertaking signing such MLR treaties as risk mitigation techniques should only take the MLR treaty into account in the standard formula if they are able to demonstrate that the treaty does not create material basis risk as required by Article 210(2) DR. For that purpose undertakings should especially assess whether the cover of the MLR treaty closely mirrors the changes in the value of the risk exposure under a comprehensive set of risk scenarios, including scenarios that are consistent with the confidence level set out in Article 101(3) of the Solvency II Directive. The results of this assessment should be part of the regular supervisory reporting (cf. Articles 306 and 309 (5) (a) DR).

3.22. Solvency II concept of lapses is particularly comprehensive, as it includes any type of discontinuance (Article 1(14) of the DR):

*‘discontinuance’ of an insurance policy means surrender, lapse without value, making a contract paid-up, automatic non-forfeiture provisions or exercising other discontinuity options or not exercising continuity options.*

3.23. Undertakings are expected to use the definition of lapse in MLR treaties that fits their risk management strategy. However, it should be noted that, from a Solvency II SCR perspective,

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<sup>12</sup> For example, EIOPA observed some MLR treaties not including the exercise of paid-up options.

using a definition aligned with Solvency II definition of discontinuance would help in minimizing any basis risk stemming from the lapse definition itself.

- 3.24. In cases where the definition of lapse in the MLR treaty is not aligned with Solvency II definition of discontinuance, insurance undertakings should assess whether material basis risk exists according to Guideline 1 on basis risk<sup>13</sup>. When defining the comprehensive set of scenarios for the assessment, undertakings should include scenarios, that are consistent with the confidence level set out in Article 101(3) of the Solvency II Directive, i.e. especially corresponding to the Value-at-Risk of the basic own funds to a confidence level of 99,5 % over a one-year period and with different combinations of exercise rates for each discontinuance option defined in Article 1(14) DR that exists in the underlying insurance contracts. The results of this assessment should be part of the regular supervisory reporting (cf. Articles 306 and 309 (5) (a) DR).
- 3.25. Undertakings should consider that the MLR treaty does not provide an effective risk transfer if the cover of the MLR treaty does not closely mirror the changes in the value of the risk exposure in any of these scenarios, i.e., if there are material differences on the risk mitigating capacity of the MLR treaty across the comprehensive set of scenarios. Materiality should be checked with the comprehensive set of scenarios, so no diversification effect due to other risks is considered (See also the Guidelines on Basis Risk, Explanatory Text).

### 3.3.3. EXCLUSIONS

- ▶ MLR treaties including exclusions create basis risk. Undertaking signing such MLR treaties as risk mitigation techniques should only take the MLR treaty into account in the standard formula, if they are able to demonstrate that the treaty does not create material basis risk as required by Article 210(2) DR. For that purpose, undertakings should assess whether the MLR closely mirror the changes in the value of the risk exposure under a comprehensive set of lapse risk scenarios, including scenarios that are consistent with the confidence level set out in Article 101(3) of the Solvency II Directive. The results of this assessment should be part of the regular supervisory reporting (cf. Articles 306 and 309 (5) (a) DR).

- 3.26. When assessing whether the MLR treaty does not provide an effective risk transfer, exclusions in the terms and conditions may be particularly relevant. Some reinsurance

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<sup>13</sup> EIOPA-BoS-14/172

arrangements were observed to exclude some events from the cover provided by the MLR, as for example:

- Mass-lapse events due to changes in legislation, including changes in taxation,
- mass lapse due to broad market behaviour (such as transfer from defined benefit to defined contribution schemes),
- mass-lapse events driven by broker recommendations or other third parties,
- mass lapse events due to worsening financial position,
- internal switching and/or splitting between the ceding undertaking's products.

- 3.27. The Standard Formula mass-lapse scenario does not include any exception, i.e., its scope includes all mass-lapse events regardless of the underlying event or events (financial crisis, unemployment, legal changes...). Therefore, exclusions from MLR treaties create basis risk. While materiality depends on the case, it should be noted that, even if these exclusions might reflect events with very low probability, mass-lapse events are extreme scenarios with very low probability (VaR 99.5%), so these exclusions might indeed represent a material share of the potential cases leading to the mass-lapse event.
- 3.28. Undertakings are expected to include exclusions in MLR treaties that fit their risk management strategy. However, it should be noted that, from a Solvency II SCR perspective, reducing the number of exclusions would help in minimizing any basis risk stemming from exclusions themselves.
- 3.29. In cases where the MLR treaty includes exclusions, insurance undertakings should assess whether material basis risk exists according to Guideline 1 on basis risk. When defining the comprehensive set of scenarios for the assessment, undertakings should include scenarios that are consistent with the confidence level set out in Article 101(3) of the Solvency II Directive, i.e. especially corresponding to the Value-at-Risk of the basic own funds to a confidence level of 99,5 % over a one-year period and with different combinations of underlying events, including those in the exemptions of the MLT treaty. The results of this assessment should be part of the regular supervisory reporting (cf. Articles 306 and 309 (5) (a) DR).
- 3.30. Undertakings should consider that the MLR treaty does not provide an effective risk transfer if the MLR treaty does not closely mirror the changes in the value of the risk exposure in any of these scenarios, i.e., if there are material differences on the risk mitigating capacity of the MLR treaty across the different scenarios. Materiality should be checked with the comprehensive set of scenarios, so no diversification effect due to other risks is considered (See also the Guidelines on Basis Risk, Explanatory Text).

#### 3.3.4. BASIS FOR THE CALCULATION OF THE CLAIM

- ▶ MLR treaties defining the claims to be paid by the reinsurer using parameters and concepts different from those used to calculate Solvency II technical provisions create basis risk.

Undertakings signing MLR treaties with such differences should be able to explain how the differences in the parameters have been accurately considered when calculating the risk-mitigating effect of the MLR treaty.

- ▶ Undertaking signing MLR treaties with such differences should only take the MLR treaty into account in the standard formula, if they are able to demonstrate that the treaty does not create material basis risk as required by Article 210(2) DR. For that purpose, undertakings should assess whether the MLR closely mirror the changes in the value of the risk exposure under a comprehensive set of risk scenarios, including scenarios that are consistent with the confidence level set out in Article 101(3) of the Solvency II Directive. The results of this assessment should be part of the regular supervisory reporting (cf. Articles 306 and 309 (5) (a) DR).

- 3.31. Claims within MLR treaties, i.e., the claims to be paid by the reinsurer to the ceding undertaking, can be defined following other concepts than those in Solvency II. Frequently these definitions are based on some kind of “economic loss” after the lapses, sometimes referred to as a loss in Value In Force (VIF). As a matter of fact, it could be related also to the capital losses deriving from the sale of the securities covering the TPs triggered by surrenders; such losses could be relevant for profit sharing contracts.
- 3.32. Undertakings are expected to define the claim in MLR treaties based on the relevant parameters to fit their risk management strategy. However, it should be noted that, from a Solvency II SCR perspective, using Solvency II parameters would simplify SCR calculation.
- 3.33. In cases where the MLR treaty defines the claim using non-Solvency II parameters (e.g., discount rates used to calculate the VIF are different from those used to calculate the best-estimate technical provisions), undertakings are expected to be able to explain the differences between Solvency II losses in the own funds and the claim defined in the MLR treaty, as well as how these differences have been considered for SCR calculation purposes.

3.34. However, it should be noted that the impact of these differences may change across the 1-year time horizon (e.g., the difference between both discount rates might change across the year). Therefore, undertakings should also assess whether these differences create material basis risk according to Guideline 1 on basis risk. When defining the comprehensive set of scenarios for the assessment, undertakings should include scenarios that are consistent with the confidence level set out in Article 101(3) of the Solvency II Directive, i.e. especially corresponding to the Value-at-Risk of the basic own funds to a confidence level of 99.5 % over a one-year period where the mass-lapse event occurs when the differences between parameters changed. Undertakings should consider that the MLR treaty does not provide an effective risk transfer if the MLR treaty does not closely mirror the changes in the value of the risk exposure in any of these scenarios, i.e., if there are material differences on the risk mitigating capacity of the MLR treaty across the different scenarios. Materiality should be checked with the comprehensive set of scenarios, so no diversification effect due to other risks is considered (See also the Guidelines on Basis Risk, Explanatory Text).

#### **Example of different basis for calculation**

Solvency II mass-lapse scenario is defined as an instantaneous event, which means that within the 1-year time horizon of the SCR additional lapses in line with best estimate assumptions (assumed best estimate lapse rates) will still occur.

If a MLR treaty does not consider expected lapses when defining the claim as well as the attachment and detachment points, there would be a difference in the basis for the calculation of the reinsurance claim and the stress under the Standard Formula.

#### **3.3.5. FIXING PARAMETERS**

- ▶ The date when the parameters of MLR treaties are fixed might create basis risk. Undertakings should only take the MLR treaty into account in the standard formula, if they are able to demonstrate that the treaty does not create material basis risk as required by Article 210(2) DR. For that purpose, undertakings should assess whether the MLR closely mirror the changes in the value of the risk exposure under a comprehensive set of risk scenarios, including scenarios that are consistent with the confidence level set out in Article 101(3) of the Solvency II Directive. The results of this assessment should be part of the regular supervisory reporting (cf. Articles 306 and 309 (5) (a) DR).

- 3.35. Mass-lapse events typically are not instantaneous events, but lapses grow over a variable period of time and, as the mass-lapse event arises, the expected lapse rate might also increase. In addition, the amount of the reinsurance claim (e.g., the loss in Solvency II own funds) depends directly on expected lapses, as lapses have a direct impact on the profitability of a portfolio of insurance contracts. Therefore, if the MLR treaty defines the reinsurance claim based on the value of the lapse parameters at the date when the mass-lapse event occurs, the real risk-mitigating effect would be lower than initially assessed, so material basis risk would arise.
- 3.36. It should be noted that, from a Solvency II SCR perspective, fixing the value of the MLR treaty parameters at the start of the measurement period would help in minimizing any basis risk stemming from this point.
- 3.37. In cases where the MLR treaty does not fix the parameters at the start of the measurement period, insurance undertakings should assess whether material basis risk exists according to Guideline 1 on basis risk. When defining the comprehensive set of scenarios for the assessment, undertakings should include scenarios that are consistent with the confidence level set out in Article 101(3) of the Solvency II Directive, i.e. especially corresponding to the Value-at-Risk of the basic own funds to a confidence level of 99,5 % over a one-year period considering how the value of the parameters would change depending on the date when the event arises. Undertakings should consider that the MLR treaty does not provide an effective risk transfer if the MLR treaty does not closely mirror the changes in the value of the risk exposure in any of these scenarios, i.e., if there are material differences on the risk mitigating capacity of the MLR treaty across the different scenarios. Materiality should be checked with the comprehensive set of scenarios, so no diversification effect due to other risks is considered (See also the Guidelines on Basis Risk, Explanatory Text).

#### 3.3.6. CLIFF-EDGE EFFECT

- ▶ MLR treaties defining the claim as the loss associated to all lapses once lapses exceed the attachment point create material basis risk.

- 3.38. The Standard Formula mass-lapse scenario is designed at VaR 99.5%, which means that the capital requirement should also be enough to cover all losses up to the confidence level and thus also less-extreme events. Tailoring the MLR treaty to the Standard Formula mass-lapse scenario might leave the undertaking vulnerable to other scenarios, therefore creating material basis risk. In particular, the mass-lapse capital requirement should be enough to cover the losses after events not covered by the MLR treaty, i.e., where the lapse rate is below the attachment point.



- 3.39. Most of the observed MLR treaties define the claim as the **loss associated to lapses exceeding the attachment point**<sup>14</sup>. For example, for a MLR treaty with an attachment point of 15% (over assumed best estimate lapse rate) and detachment point of 40% (over assumed best estimate lapse rate), in case of real lapses being 35% (over assumed best estimate lapse rate), the treaty would cover the losses associated to lapses between the interval from 15% to 35% (over assumed best estimate lapse rate).
- 3.40. However, some MLR treaties define the claim as the **loss associated to all lapses once lapses exceed the attachment point**. For example, for a contract with an attachment point of 15% (over assumed best estimate lapse rate) and detachment point of 40% (over assumed best estimate lapse rate), if real lapse rate is 35% (over assumed best estimate lapse rate) the treaty would cover the losses associated to all lapses, i.e., from 0% to 35% (over assumed best estimate lapse rate).
- 3.41. The risk mitigating effect of MLR treaties covering the loss associated to all lapses once lapses exceed the attachment point create material basis risk within the Standard Formula. The MLR treaty would transfer all losses for scenarios with lapses above the attachment point and no losses for scenarios below the attachment point, creating a sharp cliff-edge effect around the attachment point. Conversely, the real losses derived from the risk exposure constantly increase as lapses increase. Therefore, the value of this risk-mitigation technique would not closely mirror the changes in the exposure for lapse risk, therefore creating material basis risk. Indeed, allowing to consider the risk-mitigating effect of this type of MLR treaties would lead to a non-commensurate SCR reduction as, while the treaty would only transfer losses for scenarios with lapses above the attachment point, the capital relief would be 100% of the mass-lapse capital requirement. Therefore, the risk-mitigating effect of MLR treaties covering the loss associated to all lapses once lapses exceed the attachment point can only be measured through a (partial) internal model.

### 3.3.7. ATTACHMENT / DETACHMENT POINT

- ▶ The capital relief should be commensurate to the real risk transfer, which, in addition to the other elements discussed in this Opinion, requires setting an appropriate attachment point according to the risk profile of the portfolios being reinsured.
- ▶ Based on the characteristics of the product, historical lapses observed and other objective criteria, undertakings should therefore perform scenario analyses in their ORSA to assess whether this balance exists.

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<sup>14</sup> Being the attachment frequently defined as a percentage of lapses in excess of the assumed best estimate lapse rate.

- 3.42. Most observed MLR treaties have a detachment point in line with the 40% assumption of the Standard Formula (or 70% for management of group pension funds) and an attachment point which is lower. This implies that ultimately the net SCR for mass lapse depends on the attachment point.
- 3.43. The insurer's share of the loss after a mass-lapse event might decrease more or less linearly as the attachment point decreases, but the price of the cover might increase more sharply if the probability of lapses assumed does not behave linearly. This means that, for example, reinsuring the final 25% of lapses (i.e., from 15% to 40% over assumed best estimate lapse rate) is frequently significantly cheaper than reinsuring the first 25% of lapses (i.e., from 0% to 25% over assumed best estimate lapse rate), while the lapse capital relief would be very similar in both cases. This does not necessarily imply that the risk transfer is not commensurate to the capital requirement relief, as this is driven also by the non-proportional nature of MLR.
- 3.44. However, the attachment point should be calibrated considering the risk profile of the undertaking and portfolio being reinsured, as a too high attachment point might endanger the balance between risk transfer and capital release. The Standard Formula is calibrated so the stressed scenarios are covering average / typical risk profiles of undertakings, which includes a wide range of different products. If an undertaking only reinsures mass-lapse events for insurance products with low lapse risk, the capital relief might not be commensurate to the real risk transfer if the attachment point is not calibrated based on the risk profile of the portfolio reinsured.
- 3.45. Undertakings should assess in the ORSA whether the attachment point set in a MLR treaty leads to a capital relief that is commensurate with the real risk transfer using scenario analysis calibrated considering the characteristics to the product reinsured, historical lapses observed and other objective criteria.

### 3.3.8. MEASUREMENT PERIOD

- 3.46. Within this Opinion, the duration or maturity of the treaty should be interpreted as the time until the MLR treaty matures, and the measurement period should be interpreted as the risk window or cover period, i.e., the timeframe considered to aggregate lapses and potentially trigger a claim in case the attachment point is reached.

#### 3.3.8.1. Measurement period and renewals

- ▶ MLR treaties that do not provide an effective risk transfer in a comprehensive set of lapse risk scenarios, including scenarios that are consistent with the confidence level set out in

Article 101(3) of the Solvency II Directive with different start dates, should not be considered risk-mitigation techniques for SCR valuation purposes.

- 3.47. Real mass-lapse events are not instantaneous events as in the mass-lapse Standard Formula, as they span across longer periods of time. According to Guideline 1 on basis risk (EIOPA-BoS-14/172), a risk-mitigation technique creates a material basis risk if the changes in value of the risk-mitigation technique do not closely mirror the changes in value of the risk exposure of the undertaking under a comprehensive set of risk scenarios at VaR 99.5%. Therefore, measurement periods should be defined flexibly, as lapses might not arise within a predefined period coinciding with a specific cover period. For example, a 12-month mass-lapse event could start in July and it would not be properly covered by a MLR treaty with fixed cover periods equal to each calendar year). This can be achieved defining renewals through **rolling measurement periods** and a long duration, e.g., every quarter the treaty is rolled over, so three additional months are added to the treaty and a new 12-month measurement period starts.
- 3.48. For long-term MLR treaties following a rolling approach on quarterly basis, a 12-month measurement period starts every quarter and, therefore, measurement periods overlap. It is therefore natural that the MLR treaty defines the claim to avoid double counting the same lapses for different measurement periods, for example reducing the current claim by lapses that were already accounted into claims ceded to the reinsurer in the last overlapping<sup>15</sup> measurement periods.
- 3.49. However, in some cases MLR treaties include “high-water mark” clauses, which require to deduct claims paid in the past within the treaty to calculate current claim for non-overlapping measurement periods (e.g. 24-months high-water mark clause into a MLR treaty with 12-months measurement period). De facto, this type of clauses leads to a permanent increase of the attachment point after each mass-lapse event covered by the MLR treaty. This clause would leave undertakings particularly vulnerable to multi-year mass-lapse events, as after the payment of the claim for the first year, the attachment point would increase and the second year the treaty might not keep covering the multi-year mass-lapse event. In any case, undertakings should consider the impact of past claims on the cover provided by the MLT treaty in the following 12 months.

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<sup>15</sup> E.g., the last 3 measurement periods in case of quarterly roll-over and 12-month measurement periods.

### 3.3.8.2. Liquidity risk

- ▶ Undertakings should evaluate the liquidity risk arising from mass-lapse and specifically address it within their liquidity risk management system (Art. 260 DR), considering any MLR present.

3.50. It should be noted that MLR treaties might not eliminate liquidity risk arising from mass-lapse events, as an undertaking can still be exposed to it because of the time gap between lapses and payment of the claim by the reinsurer to the cedent. This might be particularly challenging in cases where a poor definition of the terms of the treaty leads to disagreement between the insurer and the reinsurer. In any case, undertakings should explicitly address this as part of their liquidity risk management, considering the specific features of the MLR treaty, including the contractual arrangements and any existing deposits, notably to take into account the potential time gap between lapses and payment of the claim by the reinsurer to the cedent.

### 3.3.8.3. Multi-year mass-lapse events

Please see section 3.2: Feedback request

### 3.3.9. EARLY TERMINATION CLAUSES

- ▶ In case of early termination<sup>16</sup>, the residual measurement period<sup>17</sup> and the residual duration of the treaty should be sufficient to ensure an effective risk transfer.

3.51. Early termination clauses allowing the reinsurer to unilaterally terminate the contract without any prior condition with a short notice period endanger an effective risk transfer, as the reinsurer could terminate the contract once lapses are getting close to the attachment point. Therefore, to allow an effective risk transfer, the residual measurement period and the residual duration in case of early termination should be sufficient in line with the

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<sup>16</sup> no-fault termination, i.e., excluding special termination rights for specific reasons envisaged in the treaty.

<sup>17</sup> The residual measurement period should be understood as the time until the end of the last measurement period still covered by the MLR treaty.

considerations in the previous section on Measurement period. In particular, early termination clauses leading to a residual measurement period lower than 12 months would create material basis risk.

#### **Example early termination**

One MLR treaty sets a measurement period of 12 months and an initial duration of the treaty of 36 months. Every quarter, a new measurement period starts and the treaty is automatically renewed for an additional quarter. The attachment point is equal to 1-in-30-year event, e.g., 15%. Each party can unilaterally decide at any point in time to terminate the contract, so no additional automatic renewals are added.

In case of early termination, the residual duration of the contract is at least 33 months, which includes several 12-month measurement periods. Therefore, the early termination clause does not prevent an effective risk transfer.

#### **3.3.10. SPECIAL TERMINATION CLAUSES**

- ▶ MLR treaties including special termination clauses<sup>18</sup> in favour of the reinsurer that have a short notice period create basis risk. Undertaking signing such MLR treaties as risk mitigation techniques should only take the MLR treaty into account in the standard formula, if they are able to demonstrate that the treaty does not create material basis risk as required by Article 210(2) DR. For that purpose, undertakings should assess whether the MLR treaty closely mirrors the changes in the value of the risk exposure under a comprehensive set of risk scenarios, including scenarios that are consistent with the confidence level set out in Article 101(3) of the Solvency II Directive. The results of this assessment should be part of the regular supervisory reporting (cf. Articles 306 and 309 (5) (a) DR).

- 3.52. Some MLR treaties include special termination clauses that allow the reinsurer to terminate the contract under special circumstances, for example:
- the insurer is unable to maintain a sufficient service level and sufficient accuracy to retain policyholders, and the insurer is not able to introduce measures to change the situation,

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<sup>18</sup> special termination clauses are those that allow the reinsurer to terminate the contract under special circumstances.

- insolvency with the insurer
  - a regulatory authority decision to restrict the (re)insurance business,
  - adoption of supervisory measures on the insurer,
  - the insurer's solvency ratio determined in accordance with the Solvency II rules is below a certain level (e.g., 110%).
- 3.53. All the events described in these clauses might trigger a mass-lapse event or be triggered by an ongoing mass-lapse event. If the reinsurer has the right to cancel the treaty on short notice in these cases, some mass-lapse events could be indirectly excluded from the MLR treaty. Therefore, special termination clauses with a short notice period in MLR treaties might create material basis risk. While materiality depends on the case, it should be noted that, even if these indirect exclusions might reflect events with very low probability, mass-lapse events are extreme scenarios with very low probability (VaR 99.5%), so these indirect exclusions might indeed represent a material share of the potential cases leading to the mass-lapse event.
- 3.54. Undertakings might include special termination clauses in MLR treaties if these fit to their risk management strategy. However, it should be noted that, from a Solvency II perspective, not including any special termination clauses with short notice periods would help in minimizing any basis risk stemming from special termination clauses themselves. If the special termination clause allows to maintain the mass-lapse cover for a residual measurement period that is not significantly shorter than the initial measurement period (long notice period), this long period notice would help in containing basis risk.

#### **Example special termination clause**

One MLR treaty sets a measurement period of 12 months and an initial duration of the treaty of 36 months. Every quarter, a new measurement period starts and the treaty is automatically renewed for an additional quarter. The attachment point is equal to 1-in-30-year event, e.g., 15%. Each party can unilaterally decide at any point in time to terminate the contract, so no additional automatic renewals are added. In special cases, the reinsurer can terminate the contract, maintaining the cover only until the end of the current measurement periods.

This special termination clause would leave a residual measurement period of between 9 to 12 months. For example, if the contract was signed on 01/01/t and the reinsurer exercises the early termination clause on 01/06/t, the contract would be terminated on 31/03/t+1 (end of the measurement period started the 01/04/t), leaving a residual cover period of 10 months. This special termination clause does not create material basis risk.

3.55. In cases where the MLR treaty includes special termination clauses with short notice, insurance undertakings should assess whether material basis risk exists according to Guideline 1 on basis risk. When defining the comprehensive set of scenarios for the assessment, undertakings should include scenarios at VaR 99.5% with different combinations of underlying events, including those potentially leading to the termination of the MLR treaty. Undertakings should consider that the MLR treaty does not provide an effective risk transfer if the MLR treaty does not closely mirror the changes in the value of the risk exposure in any of these scenarios, i.e., if there are material differences on the risk mitigating capacity of the MLR treaty across the different scenarios. Materiality should be assessed at risk submodule level, i.e., without considering in diversification effects after aggregation.

### 3.3.11. ESTIMATING THE RISK-MITIGATING EFFECT

- ▶ Undertakings signing MLR treaties as risk mitigation techniques should ensure that, when calculating the loss in basic own funds resulting from the events described in article 142(6) DR, the risk-mitigating effect can be accurately measured considering the specific terms and conditions of the MLR treaty, which frequently requires a detailed analysis of the case and granular considerations.

## 3.4. REINSURER'S PERSPECTIVE

- ▶ Reinsurance undertakings applying the Standard Formula accepting mass-lapse risk should calculate the mass-lapse capital requirement scenarios to the underlying direct insurance contracts.

3.56. The party accepting the risk in a MLR treaty is also exposed to life/health SLT mass-lapse risk, as in case of a mass-lapse event affecting all undertakings, the MLR treaty would be triggered. The Standard Formula appropriately supports this, as according to the second subparagraph of articles 142(6)<sup>19</sup> and 159(6) DR, for reinsurance treaties mass-lapse capital requirement

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<sup>19</sup> It should be noted that, while article 159(6) is clear on the need to assess mass-lapse capital requirement based on the underlying direct insurance contracts in all cases, article 142(6) inconsistently requires this only for group risk (article 142(6)(a)). However, there are no economic reasons justifying such difference and all risks assumed by the party accepting the MLR treaty should be assessed based on the underlying direct insurance contracts.

should be assessed based on the underlying insurance contracts in the life/health SLT underwriting risk module.

- 3.57. In some cases, the party accepting the risk from a MLR treaty classified it as non-life risk and did not calculate any life mass lapse capital requirement. This approach fails to recognise the real economic nature of the underlying risk going against Solvency II principles and leads to a material underestimation of the SCR, which would allow to arbitrage Solvency II regulation. The cedant would materially decrease the SCR, while the increase in the SCR of the reinsurer would be significantly lower (e.g., only 5-10% of the reduction for the cedant)”.

### 3.5. BALANCE SHEET

- ▶ Undertakings projecting MLR renewals for risk-margin calculation should consistently project the cost of MLR renewals when valuing reinsurance recoverables.
- ▶ However, undertakings should only project renewals for risk-margin calculation and reinsurance recoverables valuation when, for their specific case, they can (1) clearly justify that the risk that the MLR treaty cannot be replaced due to an absence of liquidity in the market is not material and (2) accurately estimate the risk that the cost of replacing existing reinsurance arrangements may increase. Undertakings should take into consideration that the degree of uncertainty of assumptions for (1) and (2) increases as the projection horizon becomes longer.

- 3.58. Mass-lapse reinsurance is also associated to long-term contracts which might last significantly more than the reinsurance treaty. When projecting future SCRs associated to long-term contracts, insurance and reinsurance undertakings need to make assumptions on potential replacements of reinsurance contracts, including mass-lapse treaties. This can have a material impact on the Risk Margin calculation and reinsurance recoverables valuation.
- 3.59. Article 209(3) of the DR, subject to some conditions, allows for the renewal or replacement of reinsurance to be considered in the projection of the SCR as a future management action. Article 209(3) is limited to a 12-month future period in line with the time horizon of the SCR, however, according to Article 38(1)(l) the reference undertaking used to calculate the risk margin should use future management actions consistent with those of the original undertaking. These Future Management Actions should satisfy Article 23. As clarified in



Guideline 78 on the valuation of technical provisions, future management actions include projecting future reinsurance arrangements provided the relevant criteria are met, which means that the risk margin should also consider them if the criteria are met.

- 3.60. Article 41(1) of the DR stipulates that the contract boundaries of the reinsurance recoverables should be consistent with the insurance contracts to which they relate. Guideline 78 on the valuation of technical provisions clarified that, as consequence, the reinsurance recoverable of MLR should project cash-flows relating to future reinsurance purchasing and renewals for as long as the underlying obligations, provided some conditions are met.
- 3.61. Conditions in Guideline 78 and Article 209(3) to consider future reinsurance are equivalent, therefore consideration of future reinsurance purchasing and renewals for risk margin and reinsurance recoverable valuation purposes should be consistent.
- 3.62. However, mass-lapse reinsurance is still a niche market compared to other reinsurance treaties, so justifying that the risk that the risk-mitigation technique cannot be replaced due to an absence of liquidity in the market is not material as required by Article 209(3)(e) and Guideline 78(e) on the valuation of technical provisions might be challenging considering the long projection horizon of some products covered by MLR.
- 3.63. Similarly, Article 209(3)(f) and Guidelines 78(f) on the valuation of technical provisions require undertakings to consider the risk that the cost of replacing existing reinsurance arrangements may increase, which will usually be particularly challenging considering MLR is a niche market and the usually long projection period of the obligations reinsured<sup>20</sup>.
- 3.64. Therefore, undertakings should only project renewals for risk-margin calculation and reinsurance recoverables valuation when, for their specific case, they can (1) clearly justify that the risk that the MLR treaty cannot be replaced due to an absence of liquidity in the market is not material and (2) accurately estimate the risk that the cost of replacing existing reinsurance arrangements may increase. Undertakings should take into consideration that the degree of uncertainty of assumptions for (1) and (2) increases as the projection horizon becomes longer.
- 3.65. It should be noted that approximating future SCRs for risk margin calculation based on future net best estimates (Method 2 from Guideline 61 - Methods to calculate the risk margin) usually implicitly assumes renewal of reinsurance contracts.

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<sup>20</sup> In addition, it should be noted that the proposal to amend the Solvency II Directive states that *“the calculation of the risk margin should account for the time dependency of risks”*.

## 4. REINSURANCE AGREEMENTS' TERMINATION CLAUSES ANNEX

### 4.1. DESCRIPTION OF THE CASE

- 4.1 For the purposes of the SCR calculation, (re)insurance undertakings must comply with Articles 209-211 and Articles 213-214 of the DR. This includes assessing whether the terms of the reinsurance agreements compromise the effective transfer of risk.
- 4.2 Where a reinsurance agreement's termination clauses absolve the reinsurer from its share on the legitimately incurred losses within the reinsurance treaty period, such is considered contrary to the condition defined in Article 210(4)(a) of the DR as the reinsurer may unilaterally cancel the transaction, beyond the direct control of the ceding insurance undertaking, without being obliged to pay the amounts due under the reinsurance agreement.
- 4.3 Arrangements with clauses releasing the reinsurer of its share on the legitimately incurred losses within the reinsurance treaty period due to the insolvency of the insurance undertaking or due to national competent authorities' supervisory measures should not be considered to effectively transfer risk, in the sense of Article 210(4)(a) of the DR for the purposes of the solvency calculation.
- 4.4 Where assets are transferred simultaneously with a clause stating that all premiums paid and transferred assets which are held by the reinsurer at the termination date shall be unconditionally retained by the reinsurer which will be free of all obligations, significant concerns arise in terms of policyholder protection. This arrangement prejudices the fulfilment of reinsured insurance claims in case of insolvency and creates a disproportionate contractual balance between the rights and obligations of the ceding insurance undertaking and the ones of the reinsurer. In this case, if there is a risk of insolvency, the national competent authority of the ceding undertaking should consider requesting the relevant national competent authority to prohibit the free disposal of the transferred assets located within its territory.

### 4.2 ANALYSIS OF THE CASE

- 4.5 In accordance with Article 210 of the Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 (DR), the contractual arrangements governing the risk-mitigation technique shall ensure that the extent of the cover provided by the risk-mitigation technique and the transfer of risk is clearly defined and incontrovertible. The determination that the contractual

arrangements and transfer of risk is legally effective and enforceable in all relevant jurisdictions in accordance with Article 209(1)(a) of the DR shall consider the criteria established in Article 210 (4) of the DR.

- 4.6 One aspect to be considered is whether the terms of a reinsurance agreement, that are negotiated between the parties and are subject to national contract law, compromise the effective transfer of risk. Where the transfer of risk is compromised, the capital relief in the SCR calculation provided by the risk mitigation technique shall not be considered.
- 4.7 It is common for reinsurance agreements to include termination clauses. Depending if the reinsurance agreement is on a 'risk attaching' or 'loss occurring' basis, the reinsurer is typically responsible in case of termination of the reinsurance arrangement for all legitimate losses arising, respectively, from policies that were issued or renewed during the period of effect of the reinsurance arrangement, or losses incurred and reported within the reinsurance arrangement period. As regards the new losses after the termination of the reinsurance arrangement, different articulations can be observed (runoff provisions).
- 4.8 Termination clauses fully releasing in substance the reinsurer from its share on the legitimately incurred losses within the reinsurance contract period in the event of insolvency of the ceding undertaking or in the event of the ceding undertaking being put on any form of administration by a competent regulatory body or court or in the event of actions by a national competent authority, should not be considered to effectively transfer risk, in the sense of Article 210(4)(a) of the DR for the purposes of the solvency calculation.
- 4.9 Where the assets are transferred simultaneously with a clause stating that all premiums paid and transferred assets which are held by the reinsurer at the termination date shall be unconditionally retained by the reinsurer which will be free of all obligations, significant concerns arise in terms of policyholder protection. This arrangement prejudices the fulfilment of reinsured insurance claims in case of insolvency and creates a disproportionate contractual balance between the rights and obligations of the ceding insurance undertaking and the ones of the reinsurer. In this case, if there is a risk of insolvency, the national competent authority of the ceding undertaking should consider requesting the relevant national competent authority to prohibit the free disposal of the assets, which ownership has been transferred, located within its territory.
- 4.10 In addition, such situations raise issues in terms of the undertaking and group's system of governance, as well as the fit and proper assessment of the individuals running the undertaking and the group, including the fitness and propriety of the actuarial and risk management functions (in the sense of Articles 42(1), 44 (2) (f) and 48 (1)(h) and (2) of the Solvency II Directive). Factors such as the timing of the signing of the reinsurance arrangement, the counterparty (e.g. if intra-group reinsurer), and the terms of the contract should be taken into consideration in the assessment of the fitness and propriety of the individuals running the undertaking and the group, as per Articles 42(1) and 257 of the Solvency II Directive.

SUPERVISORY STATEMENT ON SUPERVISION OF REINSURANCE CONCLUDED WITH THIRD COUNTRY INSURANCE AND REINSURANCE UNDERTAKINGS

Done at Frankfurt am Main, on 08 October 2024.

[signed]

*For the Board of Supervisors*

Petra Hielkema

Chairperson

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