RAB response to EIOPA Consultation on Annex to Opinion on the use of risk mitigation techniques - Proportional reinsurance

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Q1. Please provide any general comments to Section 3: Annex on proportional reinsurance with features reducing commensurateness.

The Reinsurance Advisory Board (RAB) welcomes the opportunity to comment on the consultation and strongly supports the acknowledgement of the critical role of reinsurance in insurers' capital management, risk diversification, underwriting capacity, and financial stability. In particular, proportional reinsurance remains a cornerstone of effective risk transfer in the European market, which should continue to be appropriately recognised in terms of capital relief.

Well-established features such as variable commissions, loss limits, or certain loss corridors may be embedded in proportional reinsurance arrangements to align incentives between cedant and reinsurer, mitigate moral hazard, thereby supporting sustainable risk transfer and long-term access to reinsurance capacity.

The RAB would therefore like to highlight the value and rationale of specific features in proportional reinsurance. Beyond the straightforward benefits of features, such as risk-transfer and cedants' protection, the value of variable commissions, loss corridors and loss limits includes aspects such as:

- Bridging the gap between the risk perspectives of insurers and reinsurers
- Enabling more cost-efficient pricing and risk-sharing by aligning incentives
- Supporting long-term partnerships by reducing the likelihood of contract repricing or cancellation following adverse experience, thereby enhancing cedants' growth and stability
- Facilitating access to reinsurance capacity by ensuring transactions remain economically viable for both parties, particularly in challenging or evolving market environments or for specific risks/portfolios.

The RAB also emphasises that reinsurance commissions are a key parameter in the economic balance of proportional reinsurance transactions, reflecting multiple components as well as prevailing supply–demand conditions in the reinsurance market.

Directly allocable claims-handling costs are reimbursed by the reinsurer. For the cedant's acquisition and administrative costs, including other unallocated claims-handling costs, it is market practice for the parties to

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agree on predefined commission rates, expressed as a percentage of the premiums. This ensures that these internal costs do not increase disproportionately to the reinsurer's disadvantage. Therefore, reinsurance commissions cannot be fully equated with the cedant’s exposure to expense volatility; in any case, expense risk is limited in non-life insurance due to the short-term nature of the underlying policies.

As proportional reinsurance involves a symmetric risk transfer across the loss distribution, capital relief is inherently commensurate with the risk transferred. This principle is embedded in the Standard Formula for non-life premium risk, which is based on premiums net of reinsurance. Proportional reinsurance should therefore benefit from a presumption of commensurateness.

This presumption is key (predictability, consistency and proportionality in the supervisory treatment) and should be rebuttable only for exceptional cases where there is clear evidence that the design of the individual treaty materially impairs risk transfer. For example, loss caps are consistent with substantial risk transfer when they apply at very remote levels, such as beyond a 1-in-200-year event.

Proportionality and materiality are central principles, specific assessments should only be applicable to certain treaties with significant risk-limiting features.

If the Annex leads to a disproportionate disallowance of SCR benefits, the use of proportional reinsurance may decline, as well as market capacity. Potential supply-side implications should caution against an overly restrictive approach. In particular, it carries the risk that the availability of proportional reinsurance in certain lines is reduced, where reinsurers cannot accept uncapped downside risk. This could incentivise a shift toward non-proportional structures or the movement of risk outside the regulated reinsurance market. Such outcomes would run counter to the macro-prudential objectives of Solvency II to promote diversification, resilience, and financial stability.

The scope of this Annex should therefore target structures with significant risk-limiting features only. Existing governance processes - including actuarial analysis, risk management, and ORSA - already provide a framework for assessing risk transfer where necessary. Therefore, supervisors should be encouraged to use information available through this framework before imposing additional requirements.

The RAB invites EIOPA to carefully consider the timing of the Annex’s publication, as this could have unintended negative consequences for the upcoming renewals. Further, an appropriate transition period should be granted to enable undertakings to meet the requirements adequately.

The RAB remains committed to supporting supervisory convergence.

Q2. Section 3.1: Description of the case. Paragraphs 3.1 to 3.5.

The description of proportional reinsurance arrangements is helpful, and it is acknowledged that certain contractual features may influence the extent of effective risk transfer in specific circumstances. The RAB supports EIOPA’s focus on the cases where arrangements include overly stretched features that demonstrably alter the economic profile of risk transfer. The RAB supports EIOPA’s emphasis on materiality and proportionality, as the impact of these features depends on their calibration relative to expected losses and volatility.

When appropriately designed, the features referred to are legitimate, important elements that minimise ultimate reinsurance costs for cedants and ensure appropriate risk transfer. As their impact depends on their calibration and the undertaking’s risk profile, specific assessments should be warranted only where they materially undermine commensurateness.

Further clarification in section 3.4 would be helpful to better reflect the general case and to ensure that such features are not interpreted by default as indicators of insufficient risk transfer. The RAB recommends amending reinsurance advisory board

Section 3.4 first sentence with the following additions: "**If not appropriately designed**, the referred features [...] **may** significantly limit the amount of risk transferred and jeopardise commensurateness", to reflect that the Annex only addresses the impact these features may have on the effectiveness of the risk transfer as stated in 2.4.

The RAB agrees that significant variable commissions may reduce risk transfer. Their impact depends on their proportion relative to any additional fixed commissions, as well as on their scale, structure and triggers, in relation to expected losses and volatility – these points could be further clarified in Section 3.5.

While they adjust remuneration, they do not undermine the reinsurer's material exposure to adverse loss development, reserving uncertainty, and timing risks, because by definition, variable commissions can never economically absorb loss scenarios (reinsurers pay a commission to the primary insurer, not the other way round).

For most users of the standard model, the calibration of loss caps and corridors (typically at confidence levels above 1-in-200) is aligned with Solvency II and not expected to affect commensurateness. This should be clearly stated in the opinion.

Loss caps should not be considered to have a significant impact on risk transfer where they exceed a 200-year return period. The impact of loss corridors should only be considered where they materially affect risk transfer.

Regarding the example of a quota-share reinsurance treaty with a loss cap of 80%, risk transfer is reduced for losses above an 80% loss ratio. However, the impact on commensurateness depends on how the loss cap compares with the loss profile of the underlying line of business.

For portfolios with structurally lower loss ratios, an 80% threshold may lie well above the 1-in-200 calibration. In practice, loss caps are typically set at or beyond this level and are therefore frequently consistent with Solvency II. The RAB recommends amending the last sentence in Section 3.4 as follows: "However, the risk transfer of the treaty with the loss cap is lower, **especially when the loss cap is below the potential 1-in-200-year loss ratio."**

Similarly, loss corridors would only warrant prudential adjustments where they materially affect risk transfer. In most cases, they remain consistent with an effective transfer of risk.

Q3. Section 3.2: Assessing the balance between risk transfer and capital release. Comments to the blue box.

The RAB supports the acknowledgement that "commensurateness between risk transfer and capital release […] usually exists in proportional reinsurance treaties". The Standard Formula is designed as a simplified framework and deliberately assumes a proportional relationship between exposure reduction and SCR relief for proportional arrangements. This is an intentional feature of the Solvency II framework.

The RAB also supports the emphasis on proportionality and on requesting specific assessment only where features demonstrably alter the economic profile of risk transfer. The RAB also agrees on the importance of ensuring commensurateness "when considering all risk mitigating techniques together".

The RAB acknowledges the importance of the actuarial function's opinion on the adequacy of "overall reinsurance arrangements" (Article 272 of the Delegated Regulation), as well as the ORSA assessment of deviations of the undertaking's risk profile from the Standard Formula assumptions.

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Indeed, Solvency II already provides mechanisms to address potential limitations of the Standard Formula. Where certain treaties exhibit significant risk-limiting features that reduce commensurateness, their impact can be assessed specifically within the ORSA. Where material deviations are identified, this may warrant consideration of more risk-sensitive approaches, including undertaking specific parameters or internal models capable of capturing the specific features of reinsurance arrangements. Any adjustment should remain risk-based, proportionate to the extent of the deviation and not result in a full disallowance of SCR benefits.

Furthermore, the effectiveness of reinsurance arrangements is already assessed through pricing frameworks, underwriting guidelines, actuarial validation, risk appetite processes, and ORSA-based stress and scenario analyses. Introducing an additional granular assessment layer may therefore increase complexity without delivering material improvements in risk sensitivity for most proportional reinsurance treaties.

In summary, specific features in proportional reinsurance arrangements do not invalidate the Standard Formula's underlying assumptions and should not call into question the proportional relationship between exposure reduction and SCR relief in the general case.

A stronger emphasis on proportionality, combined with existing governance tools and supervisory dialogue, would provide an appropriate approach.

Q4. Section 3.2: Assessing the balance between risk transfer and capital release. Paragraphs 3.6 to 3.15.

The RAB agrees that, if certain treaties show very significant risk-limiting features that reduce commensurateness, a specific assessment could be needed, taking into account the characteristics of these features and the other elements mentioned in Section 3.9.

To ensure consistency of this paragraph, the RAB recommends amending the statement of Section 3.8, third sentence, with the following addition: "in essence,…**may in some cases** (partially or even fully) offset the changes…."

The RAB fully supports the statement in Section 3.15 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. Such assessments should only be expected in case of well-grounded concerns regarding the commensurateness of a specific treaty.

The RAB appreciates the illustrative, non-exhaustive references to quantitative tools such as Monte Carlo simulations or Expected Reinsurance Deficit (ERD) metrics, which are often used in the market. While these tools may provide useful insights, the RAB stresses that they also have limitations:

- No single quantitative indicator can demonstrate commensurateness in all circumstances; results are highly sensitive to modelling assumptions and data limitations, particularly for low-frequency, high-severity risks.
- Due to differing assumptions, these methods may produce divergent results across firms and lead to inconsistent interpretations across supervisors. Overreliance on such tools could therefore undermine comparability.

These tools must remain supportive diagnostics and not become de facto supervisory benchmarks. This should be clearly stated in the opinion.

A specific drafting point concerns the Expected Reinsurance Deficit (ERD) formula in footnote 9, which deducts commissions from premiums in the denominator. International practice, including the German regulatory framework, considers premiums without deducting commissions. The formula should therefore be reviewed accordingly.

For clarity, in Section 3.12, the "plain proportional reinsurance treaty" should be referred to as the "follow-the-fortunes proportional reinsurance treaty," and "*whether there is actual*," before "risk transfer," should be removed, as even contracts with a lower, but positive, ERD allow some risk transfer. Furthermore, the case of stable, profitable original portfolios, in which the original gross portfolio does not have significant loss potential for the cedant, should be considered when discussing cases with low ERD values under 3.13.

Proportional reinsurance treaties should continue to benefit from a presumption of commensurateness, unless this is clearly rebutted by significant risk-limiting features that demonstrably impair risk transfer. Implicit expectations of frequent or complex quantitative assessments for standard proportional reinsurance treaties could create significant operational burdens for limited prudential benefit and may conflict with proportionality principles. Qualitative assessment should therefore remain central, with quantitative analysis used only where necessary as a complement. Therefore, we support the general idea of Sections 3.12 to 3.14.

Q5. Please provide any comments to Section 4: Commissions in the volume measure for non-life premium risk (Q&A 1898). Paragraphs 4.1 to 4.5.

The RAB welcomes this consultation. Reinsurance commissions should generally not increase cedants' non-life premium risk volume measure.

Reasons:

1. Concerning proportional reinsurance, expense risk stems from cedants' un-reinsured expenses, not from commissions per se. High fixed commissions strengthen cedants' own funds. Adding back commissions to cedants' volume measure would favour low-commission structures over contracts with lower loss ratios and higher commissions for solvency relief, leading to unintended outcomes as higher commissions enhance cedants' own funds compared to low-commission structures, whilst the latter do not fully cover cedants' expenses and reduce their own funds.
2. Expense risk corresponds to the exposure to volatile expenses. However, in non-life, expense risk is generally limited (short-term policies, no lapse risk, annual renewals).
3. Expense risk is embedded in non-life premium risk via prudent calibration of the standard deviation, and into reserve risk, where the stressed best estimate already includes claims-related expenses and their associated volatility.
4. Under proportional reinsurance, reinsurers cover allocated claims-related expenses (e.g. loss adjusters' and lawyers' fees) proportionally, while overhead expenses are typically factored in the commissions. Even in stress scenarios, insurers can absorb extra workload through temporary solutions rather than new hires. Further, there is no expense volatility for acquisition and administrative costs, as these do not depend on the number of claims. Instead, these costs depend on the number of policies, and as commissions scale as a percentage of increased premium volume, cedants receive higher commissions.
5. Expenses already not covered by reinsurers have an immediate own funds effect, i.e. lowering the numerator of the SCR-ratio.
6. The remaining expense risk for not covered unallocated claims handling expenses presents only a limited component of the standard deviation. In fringe cases, any residual expense volatility, if material, should

be addressed through a proportionate, limited adjustment of the standard deviation rather than a volume measure increase or, if not material, via ORSA.

Therefore, the RAB proposes to amend:

- Q&A 1898 last sentence: As a reinsurance commission is a transaction from the accepting undertaking to the ceding undertaking to cover the overhead expenses incurred by the ceding undertaking although the actual operational handling is not transferred to the accepting undertaking (e.g. claims management – of all claims – is still performed by the ceding undertaking), reinsurance premiums entering the volume measure calculation should be gross of reinsurance commissions.
- 4.3 Expense risk corresponds to the exposure to volatile expenses, as opposed to fixed expenses. Expense risk is usually limited in non-life insurance, however, fixed reinsurance commissions could represent residual exposure to expense risk for the cedant. In case expense risk is transferred through a proportional reinsurance treaty, i.e. reinsurers pay back the part of the proportional premium ceded that covers the expenses of the cedant, i.e., it mostly represents the gross cedant's exposure to expense risk. In such a case, fixed reinsurance commissions should be considered to be part of the premium ceded, representing ceded exposure to expense risk.
- If for certain lines of business, material expense risk is not largely transferred through a proportional reinsurance treaty, its impact through reinsurance commissions on the premium risk SCR should be considered, if significant. However, only a marginal part of the standard deviation calibration for the premium risk may correspond to expense risk and ORSA reporting may be sufficient. Irrespective of the volatility of expense payments, fixed reinsurance commissions, not fully covering the cedant's expenses, already have an impact on the cedant's own funds – as reflected in the SCR and MCR ratios.
- 4.4 Variable commissions (i.e. sliding scale commission or similar loss-dependent conditions) 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 also do not lead to any adjustment of the volume measure, as discussed in the previous section, but they may, in fringe cases, jeopardise 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 expense risk for the cedant that is not transferred through a proportional reinsurance treaty, and that should be considered as discussed in the previous sections.

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Through its member bodies, the RAB represents more than 50% of total worldwide reinsurance premium income. The RAB promotes a stable, innovative and competitive market environment. It further promotes a regulatory and trading framework that facilitates global risk transfer through reinsurance and other insurance-linked capital solutions.