Position Paper

PRIIPs provisions that require clarification at level 3

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Summary

Following the application of PRIIPs in January 2018 several issues regarding the implementation of the PRIIPs KID have come to light. Insurance Europe urges the joint committee of the European Supervisory Authorities (the 'ESAs') to urgently clarify the application of certain PRIIPs requirements to ensure that European consumers are provided with clear and accurate information in the PRIIPs-KID.

As the PRIIPs Regulation has already entered into force and PRIIPs KIDs have already been distributed, Insurance Europe also urges the ESAs to ensure that any changes to the required presentation of the PRIIPs KID are introduced simultaneously, allowing KIDs to be recalled and amended in one go. A series of piecemeal changes would cause significant compliance risks for insurers and would be confusing for consumers and distributors. It is also vital that insurers have sufficient time – at least six months – to implement any changes necessitated by additional Q&A guidance.

Insurance Europe also notes, that although the proposed clarifications set out below would go some way to mitigating the most serious issues with the PRIIPs KID, they will not solve the problems with the PRIIPs-KID completely. These will need to be addressed more thoroughly as part of the full review of the Regulation mandated under Article 33 PRIIPs.

- **Performance Scenarios**

The European insurance industry is very concerned by the ranges of projected performance presented to consumers when calculating performance scenarios on the basis of the PRIIPs RTS methodology. The heavy reliance on the recent past performance of the underlying assets frequently results in performance in the favourable scenario at over 50% growth. This is misleading to consumers, as such growth will never materialise. It also operates as a disincentive to sensible investment as equally exaggerated losses will be projected following poor market performance, creating the impression the consumer should buy at the top of a market and not invest at the bottom.

In the longer term, the ESAs and European Commission should completely overhaul these calculations so that they provide consumers with more meaningful projections. This would be best achieved through 'what if?' scenarios rather than probabilistic modelling.

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As an interim measure, we request that the ESAs produce Q&A guidance allowing additional explanations of the scenarios to be added to the PRIIPs KID, as has already been permitted by national supervisors in Germany and the UK[1].

- **Whole life products**

Some funeral contracts and other whole life products with a surrender value fall within the scope of PRIIPs as they do not meet the conditions of the Article 2(2)(b) PRIIPs exemption for life insurance products. These products are not intended to be investment products. The PRIIPs KID is not always appropriate for these products and it does not provide meaningful information on the product to consumers unless adaptations are made.

The ESAs should clarify how the PRIIPs indicators and narratives should be applied to these contracts and whether any adaptations are permitted.

- **Warning on additional distribution costs**

Under Article 8(3)(f) PRIIPs, the KID must include a clear indication that advisors, distributors, or other persons advising on the PRIIP will provide additional information on additional costs charged. Annex VII builds on this, requiring a specific warning that additional costs may be charged. In certain Member States, standard contracts between insurers and distributors make this impossible, however these descriptions must still be included in the KID. This is potentially misleading to consumers. The ESAs should clarify that this warning does not need to be included where additional costs cannot be charged.

- **Treatment of annuities**

Insurance Europe does not believe that annuities are PRIIPs, nor that it is appropriate for KIDs to be produced for annuities. We urge the ESAs and the European Commission to clarify that annuities should not be considered to be in scope of PRIIPs.

However, we recognise that some annuity products are currently considered to meet the definition of a 'PRIIP' and therefore are considered in scope of the Regulation. There should be an explicit clarification through Q&As that for annuity products with an accumulation phase (deferred annuities) only the accumulation phase should be presented in the KID.

For those annuities in the scope of the PRIIPs Regulation, it remains unclear how the RTS apply, given the characteristics of such products. In order to ensure that consumers are presented with clear and accurate information, the ESAs should clarify how performance scenarios are to be calculated and presented for annuities. In particular:

- The recommended holding periods (RHP) to be used for the purposes of calculating the performance scenarios in compliance with Point 20 of Annex IV of the PRIIPS RTS should be clarified, as it is currently unclear which timeframe to use for lifelong products. A possible solution could be to consider the RHP the life expectancy of an average retail investor. Although life expectancy depends on the age of the retail investor (e.g. 20 years for a 65-year old person and 11 years for a 75-year old person) and would depend on the mortality table used by each insurance undertaking, using an average would still be appropriate as it is clear the KID is not a personalised document.

- Additionally, the templates for the presentation of the performance scenarios require insurance undertakings to use a concrete number for the RHP. This can be confusing for clients who are

[1] https://www.fca.org.uk/news/statements/statement-communications-relation-priips

contracting life-long annuities and expect to receive an annuity until the moment they die, regardless of when that is. In the case of life-long annuities, the end of the recommended holding period should be presented as the word 'life-long' instead of a concrete number.

- The total performance of a life-long annuity, both in terms of percentages and absolute values, is very difficult to reflect in the performance scenarios. Part 2 of Annex V of the PRIIPs RTS provides that for insurance-based investment products additional rows are included in respect of the survival scenario for the insurance benefits including the cumulative biometric risk premium for a regular premium insurance-based investment products. Returns for that scenario are shown in absolute values. However, the performance of immediate life annuities is determined not only by the amount received by the retail investor in case of surrender or by his/her beneficiaries in case of death, but also by the annuity payments received by the retail investor until the moment he/she surrenders or dies. Flexibility should be introduced in the current format to allow this to be reflected, possibly through an additional explanatory statement.

- In addition, the performance scenarios do not reflect the important role played by the biometric component in the performance of the overall product. The performance of an immediate life annuity is determined not only by the financial performance of the product (e.g guaranteed interest rate net of all applicable cost) but also by the biometric performance of the product. If a retail investor buys a product at retirement age that guarantees a life-long income, but only lives for 3 years, they will make a loss. If they live much longer the investor will make a gain, on the basis of not only the guaranteed interest rate but also by the additional biometric performance. The total performance of this kind of immediate life-long annuity, both in terms of percentages and absolute values, is very difficult to reflect in the KID.

- The current presentation of performance is also inappropriate for life-long annuities with mortality guarantees. For these products, the retail investor receives a guaranteed fixed monthly payment until the moment they die. In case of death of the retail investor, their beneficiaries receive a percentage of the premium paid. In case of surrender, the insurance contract provides a contractual surrender value capped by the market value of the assigned portfolio of long-term assets backing the liabilities. For this kind of life-long annuity, the PRIIPs KID does not reflect the nature of guaranteed product at the end of the recommended holding period because all survival scenarios must reflect the amount that would be received by the client in case of surrender at a specific moment (e.g. 20 years), even if experience demonstrates that the surrender rate of these products is very low (1-3%). Alterations to the KID should be permissible in order to reflect that early surrender is unlikely.

- **Specific information for MOPs underlying options**

Insurance Europe remains concerned about the inconsistent application of PRIIPs provisions related to MOPs. In general, we understand that the information in the generic KID should include information about the overall product, with specific information about each underlying option included in the specific KIDs. In this context, information and indicators should generally relate only to the underlying investment options and should not be aggregated with the information on the overall insurance product itself. However, we have not been provided with legal certainty on this point.

Although we do not believe that specific information on the overall product should be included in the specific KIDs, there are instances where some adjustments to the indicators would be helpful, to better reflect the nature of the product. For example, within some MOPs, the underlying option is meant to be held for the entire holding period and it would be helpful from a consumer's perspective to adjust the RHP in the specific information on the underlying investment option (Article 14 of the RTS) to the RHP of the MOP, while for other products it could be more meaningful to use different holding periods.

In addition, certain narrative descriptors required in the KID are not suitable for MOPS products. In particular:

- The wording 'the risk indicator assumes you keep the product […]' is misleading as risk indicator in respect of MOPs regards the underlying investments (and not the product as such) and it is the recommended period of retention in respect of the underlying investments that is relevant. (Annex III (1)). It should be permissible to alter this wording to "The risk indicator assumes you keep the underlying holdings" where appropriate.

- The wording 'the actual risk can vary significantly if you cash in at an early stage', should be adjusted to reflect that the risk indicator in respect of MOPs concerns the underlying investments (and not the product as such). In respect of MOPs, the text may be relevant for some, but not all, underlying investments (Annex III (1)). It should be permissible to change the wording to 'the actual risk of certain underlying holdings can vary significantly if you cash in at an early stage'.

- The explanatory wording of the summary risk indicator is misleading for MOPs, as the summary risk indicator refers to the underlying investments and therefore does not take into account the credit risk of the insurance companies, but the credit risks for the underlying investments. Therefore, it is misleading to say that the risk indicator shows how likely it is that the product will lose money because 'we are not able to pay you', which is requested in the RTS. (Annex III, (7)(A)) It should be permissible to remove the wording or change it to 'the issuer of an underlying holding cannot pay'.

- The wording regarding currency risk is misleading as there may be currency risks in the underlying investments, but not in the insurance product itself. It is also misleading to state 'you will receive payments in a different currency' (Annex III (7)(C)). It should be permitted to change the wording to 'there are underlying investments that are registered in another currency. This currency risk is not reflected in the risk indicator above'.

- The language used in the specific information provided in accordance with Article 14 RTS is also not adjusted to reflect that the insurer is not the manufacturer of a MOPS product. The use of 'we' and 'us' should be replaced for MOP products with the name of the product manufacture. Equally, the word 'product' should be changed to 'the underlying investment option' to reflect the nature of the product.