Technical Paper

# Insurance Europe concerns over the ESAs PRIIPs final draft RTS

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| Referring to: | Joint Committee Final Draft Regulatory Technical Standards (RTS) with regard to presentation, content, review and provision of the Key Information Document (KID) (JC 2016 21) | | |
| Related documents: | Regulation 1286/2014 on Packaged Retail and Insurance-based Investment Products (PRIIPs) | | |
| Contact persons: | Olivia Fabry, Policy Advisor Conduct of Business<br>Alexandru Ciungu, Policy Advisor, Macroeconomic & taxation | E-mail: | Fabry@insuranceeurope.eu<br>Ciungu@insuranceeurope.eu |
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## Introduction

Insurance Europe supports the objective of the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation to help enhance consumer protection by improving the transparency and comparability of PRIIPs.

However, Insurance Europe believes that the final draft Regulatory Technical Standards (RTS) on presentation, content, review and provision of the Key Information Document (KID) submitted by the Joint Committee of the European Supervisory Authorities to the European Commission on 7 April 2016 will not achieve this objective.

The final draft RTS are not adapted to insurance-based investment products and are in many ways extremely unclear. As such, they will fall short on helping consumers to compare different PRIIPs on the market and make informed decisions.

Therefore, Insurance Europe wishes to highlight hereafter the key technical concerns the industry has over the current final draft RTS.

Insurance Europe calls on the European Commission to address these issues urgently in the final RTS in order to ensure that the PRIIPs KID delivers its intended objective and truly benefit consumers in practice.

Insurance Europe aisbl
Rue Montoyer 51, B-1000 Brussels
Tel: +32 2 894 30 00 • Fax: +32 2 894 30 01
E-mail : info@insuranceeurope.eu
www.insuranceeurope.eu

## Risk indicator

- **Product categorisation for the purpose of market risk assessment**

As the text of the RTS currently stands, the definitions used for product categorisation are unclear and do not enable the insurance industry to understand in which category their different products will fall for the purpose of determining which market risk assessment methodology to apply.

A clear and straightforward way of defining these categories and understanding which type of product falls in each category is needed in the RTS so as to avoid legal uncertainty.

➔ *Recommendation: The final RTS should establish clearly the methodologies that have to be applied by manufacturers for their products, in particular for the purpose of market risk assessment, in order to ensure legal certainty.*

- **Market risk measure (MRM) for guaranteed products**

The market risk methodologies included in the final draft RTS are very complex and burdensome for the industry to apply. Insurance Europe strongly believes that it is disproportionate to apply such methodologies to products such as PRIIPs that offer a guarantee at maturity of the product. On this basis, a shortcut would be welcome.

However, it is unclear whether a shortcut is currently included in the final draft RTS and whether paragraphs 24 and 29 of Annex II of the final draft RTS could be used to this end.

➔ *Recommendation: The final RTS should introduce that PRIIPs that offer a capital protection at maturity of the product should be automatically allocated to MRM class 1. This shortcut, as well as its application, should be clearly spelled out so as to avoid legal uncertainty.*

- **Credit risk for insurance-based investment products**

The Level 1 text of the PRIIPs Regulation does not require the credit risk of the provider to be taken into account in the risk indicator. The text instead refers to "*risks which are materially relevant to the PRIIP*".

For insurance-based investment products, market risk is actually the most relevant factor. Credit risk should therefore not be integrated in the quantitative risk indicator for insurance-based investment products. Indeed, Solvency II ensures that providers hold significant amounts of capital to cover all risks, including operational risks, very strict governance standards, supervisory oversight and early intervention processes. These measures have been put in place to ensure that consumers are adequately protected. Even in the unlikely event of failure of the provider, policyholder claims take precedence over other claims for the insurer.

For all these reasons, if the credit risk is to be considered at all, any insurance-based investment product should automatically be classified as credit risk measure 1.

Moreover, the final draft RTS base the calculation of the credit risk on inappropriate methodologies which do not reflect the robust Solvency II safeguards that insurers comply with. Instead, the final draft RTS base the credit risk calculation on credit ratings. Such an approach does not take into account the fact that the vast majority of insurance companies, including small and medium-sized insurers, do not have a credit rating and will therefore be by default allocated to credit risk measure 3, without taking into account the Solvency II regime they are subject to.

In addition, the final draft RTS aggregate market and credit risk into the KID summary risk indicator[1] in a way that means that, in most cases, the highest of the market risk or the credit risk is taken as the KID risk indicator. This could lead to the inappropriate result of having only the credit risk presented as the KID risk indicator for insurance-based investment products. This would also mean that consumers may be faced with a situation in which they compare a risk indicator given by the market risk for one PRIIP with a risk indicator given by the credit risk for insurance-based investment products. This would not be a meaningful comparison.

A provision set out in paragraph 47 of Annex II of the final draft RTS allows for automatic allocation to credit risk measure 2, under three conditions. However, the wording of these conditions is not sufficiently clear and does not provide the necessary legal certainty that insurers under Solvency II fulfil these conditions.

- ➔ *Recommendations:*
  *The final RTS should be amended so as to ensure that consumers are not misled by a KID risk indicator that presents risks which are, ultimately, immaterial to the product. Therefore, for insurance-based investment products, the risk indicator should only rely on the market risk.*
  *If the credit risk is to be considered at all, any insurance-based investment product should automatically be classified as credit risk measure 1.*
  *If not, the RTS should clearly set out that insurers under Solvency II meet the three conditions of paragraph 47 of Annex II for automatic allocation to credit risk measure 2.*

## Performance scenarios

- **Performance scenarios calculation methodologies**

The new provisions related to the performance scenarios[2] fail to adopt a proportionate approach and would eventually require manufacturers to go through the complicated and burdensome process of implementing and running, in some cases, a minimum of 10.000 forward-looking simulations following the required bootstrapping methodology.

The logic behind the introduction of an alleged "shortcut" for the market risk calculations, whilst still making it necessary for manufacturers to undertake the complex calculations for the performance scenarios, is not clear.

- ➔ *Recommendation: The final RTS should ensure that a more coherent and consistent approach is taken in the final RTS, for all sections of the KID, and limit the level of complexity of the methodologies to be followed, especially for insurance-based investment products. This means that the "shortcut" for market risk calculation applies to performance scenarios calculation as well.*

- **Insurance benefits presentation**

A "death scenario" – which was not part of the previous consultations - has been included in the performance scenarios in the final draft RTS, although other parts of the final draft RTS refer to insurance benefits.

While the final draft RTS correctly show that death benefits provide surviving family members with funds allowing them to maintain their living standards, they do not take into account the fact that many insurance-based investment products offer more than just a death benefit on an optional basis. In other cases, an insurance PRIIP has no *inherent* death cover providing for a specific amount at death, but simply pays out the amount saved up to the time of death.

In the latter case, presenting a separate "death scenario" has no added value as it will show exactly the same amounts as the moderate scenario. However, usually these products offer the retail investor an *option* to add a

[1] See Annex II, part 3 of the ESAs final draft RTS
[2] See Annex IV of the ESAs final draft RTS

death cover. This optional death cover can take on different forms according to the wishes of the retail investor (fixed amounts, variable amounts, services such as funeral arrangements). Taking into account this vast variety of options in the death scenario is infeasible and without added value for the retail investor.

It would be unworkable that all these different options are presented throughout the KID. However, the final draft RTS do not establish clearly that the KID should not present the optional coverages that a consumer may wish to get as part of his /her insurance cover.

Such legal uncertainty about what aspects of the insurance cover need to be presented in the KID (and under what form) is very concerning for insurers. The insurance sector believes that information about optional protections should simply not be conveyed through the KID, in any sections of the document.

➔ *<u>Recommendation</u>: The final RTS should clarify that manufacturers can explain the optional covers qualitatively in the 'what is this product?" section of the KID and should not quantify the optional coverages that a consumer may wish to get as part of his /her insurance cover.*

- **Proposed "death scenario" – inclusion of the biometric risk premium**

The proposed "death scenario" includes a presentation of the biometric risk premium. This means that the insurance premium will have to be displayed in different forms several times in different sections of the KID:

1) in the 'what is this product?" section
2) in the cost section
3) in the performance section

This risks confusing consumers and make it harder for them to get a clear understanding of the product.

➔ *<u>Recommendation</u>: The final RTS should ensure that, in the interest of consumer understanding, the biometric risk premium is presented in a transparent way once and in one format in the section "what is this product?".*

## Presentation of costs

- **Biometric risk premium and investment costs**

The Level 1 text of the PRIIPs Regulation provides that the KID should show costs "*associated with an investment in the PRIIP*".

Despite this, the final draft RTS require that insurers aggregate the cost part of the biometric risk premium – which is clearly not an investment cost – with investment costs in a single cost indicator.

No part of the insurance biometric risk premium should be presented in the investment cost section of the KID, given that the premium is providing an additional insurance coverage.

This insurance protection is unique to insurance-based investment products and is secured by the payment of the insurance premium (i.e. the price to pay in exchange for these insurance services). A sharp and clear distinction must, therefore, be made between investment costs associated to the insurance-based investment product and the insurance premiums paid.

If the biometric risk premium and the investment cost are not presented separately, then the consumer will not be in a position to compare what is comparable:

- The cost indicator of an insurance-based investment product will be deceptively higher than that of other PRIIPs, and consumers will not be in a position to compare the investment part with different products on the market.

- The amount of the insurance premium will not be clearly visible to consumers and this will prevent them from comparing the insurance cover, including the potentially high benefits if the insurance cover payment is granted. It will also prevent them from comparing the premium with the ones offered through other insurance-based investment products and through pure term insurance products with no investment component.

Therefore, in order to achieve meaningful comparison, the biometric risk premium for the inherent insurance cover should only be presented in the "*what is this product?*" section and not in the performance scenarios nor in the costs section of the KID.

➔ *Recommendation: The final RTS should ensure that, in the interest of consumer understanding and product comparability, the inherent biometric risk premium is presented in a transparent way once and in one format in the section "what is this product?".*

- **Annualised costs**

The representation of annualised costs in monetary terms ensures comparability of products with different terms and has also proven to be useful and understandable for consumers.

However, the final draft RTS requires the total cost to be presented in monetary terms. This approach does not allow consumers for an effective comparison between, for example, a product with a few months recommended holding period and one characterised by a 35 years investment recommended holding period.

➔ *Recommendation: The final RTS should present annualised costs in monetary terms in the cost section of the KID.*

## Intermediate values in performance scenarios and cost sections

The final draft RTS require that the performance scenarios and the cost sections of the KID include the requirements to explain the performance of a PRIIP after 1 year, at the middle of the Recommended Holding Period (RHP) and at the end of the RHP. Insurance Europe believes that presenting such intermediate periods will mislead consumers.

Firstly, for products with a fixed term, the KID should describe the characteristics of the PRIIP under the assumption that the regular term (ie the recommended holding period) is adhered to. For this reason, the term of the product is prominently displayed in the section titled "what is this product?". The consumer will use the term of the product as a parameter to subsequently consider the information on risk, costs and performance of the product.

Secondly, it is essential that consumers have a clear understanding of the consequences of cashing in before the end of the term of a contract. For this reason, the KID includes a dedicated section to explain the consequences of such a scenario: "How long should I hold it and can I take money out early?".

Information on intermediate values in other sections of the KID would mislead consumers. The value of a product with a 30 year term at 15 years is not the same as the final value of a product with a 15 year term. In addition, applying a short holding period to a very long-term life insurance product would result in unfair comparisons being drawn with other types of PRIIPs. Insurance-based investment products tend to be long-term products and are selected by consumers for this reason. Showing returns and costs after 1 year in the KID is irrelevant for these long-term products, especially since these products also include a 30 day cooling off period.

➔ *Recommendation: The final RTS should be amended so as to ensure that the KID will present the performance scenarios and the costs only at the recommended holding period. Alternatively, at least more proportionate and realistic illustration of long-term products should be foreseen.*

## PRIIPs offering a range of options for investments

The level 1 of the PRIIPs Regulation establishes that, for PRIIPs offering a range of options for investment, the KID shall provide a general description of the underlying investment options and "state where and how" more detailed information can be found for the underlying investment options.

However, the final draft RTS go beyond the level 1 text by establishing two options for manufacturers that would ultimately oblige them to develop key features of a PRIIPs KID for each investment option (ie. comprehension alert, investment objectives, summary risk indicator and performance scenarios, presentation of the costs), although they do not manufacture these products themselves.

This is because Article 14 of the final draft RTS does not include a requirement to "state where and how" more detailed information can be found, but rather requires the provision of information in the KID format as established in the final draft RTS. This information is not available anywhere at this stage and would, thus, need to be produced by insurers for each investment option. Given that most unit-linked products offer a significant number of investment options (100 or more in some cases), this would lead to a highly disproportionate compliance burden. Furthermore, insurers cannot be liable for producing information for products they do not manufacture.

It is also unclear whether this specific information for the underlying options would have to also include information about the overall PRIIP, which would make the requirement even less feasible and disproportionally burdensome for the industry.

The process for insurers to develop PRIIPs KID's key features for UCITS and other underlying investment options would be very problematic because insurers do not currently hold the data needed to calculate the performance scenarios as well as risk and cost indicators. This will leave insurers no choice than to withdraw some products from the market and/or stop offering some investment options.

If left in its current form, the final draft RTS would effectively restrict product variety on the market to the detriment of consumer choice.

- ➔ *Recommendation: The final RTS should not include the current Article 14 which ultimately oblige insurers to develop PRIIPs KID's key features for each investment option in the case of PRIIPs offering a range of options for investments, which is unfeasible.*

## Scope

The final draft RTS provide no legal certainty on whether manufacturers must develop and publish a KID for closed businesses or not. Considering that KIDs are aiming to ensure comparability between PRIIPs at pre-contractual stage, the insurance sector considers it irrelevant for manufacturers to develop and publish KIDs for closed businesses which are not offered anymore on the market, including when top-ups, variations or changes to individual contracts are made as part of the contract terms.

- ➔ *Recommendation: The final RTS should clarify that manufacturers should not develop a KID for closed businesses, in order to avoid unnecessary and disproportionate burden for the industry.*

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