

## PRIIPs RTS provisions that require clarification at Level 3

Our reference:	COB-PRI-17-027	Date:	6 April 2017
Referring to:	Level 3 measures (Q&As by the European Supervisory Authorities (ESAs) and a future European Commission communication)		
Contact person:	Alexandru Ciungu, policy advisor, macroeconomics & taxation	E-mail:	ciungu@insurancееurope.eu
Pages:	5	Transparency Register ID no.:	33213703459-54

### Introductory comment

Insurance Europe welcomes the recent adoption and publication of the revised Regulatory Technical Standards (RTS) for the Packaged Retail Investment and Insurance Products (PRIIPs) Regulation. The changes introduced in these revised RTS constitute a clear improvement when compared to the previous version of the RTS that had been rejected by the European Parliament. Nevertheless, a number of clarifications are required in the context of the Level 3 measures (Q&As by the European Supervisory Authorities (ESAs) and a future European Commission (EC) communication). These clarifications are essential to ensure that the industry has the necessary degree of legal certainty to appropriately implement the various provisions of the PRIIPs regulation.

### Main clarifications needed

#### ■ Credit risk

In the rejected RTS, Paragraph 47 of Annex II allowed for automatic allocation to credit risk measure 2, under three conditions. However, the wording of these conditions was not sufficiently clear and did not provide the legal certainty that insurers under Solvency II fulfil these conditions.

- 47(a) required that the assets backing the payment obligation of the PRIIP are at all times until maturity equivalent to the payment obligations of the PRIIP to its investors. Depending on how this wording was interpreted, insurance-based investment products may or may not have been compliant (e.g. guaranteed products with a 30 year Recommended Holding Period (RHP) where the insurer initially matches the payment obligation with assets that have a maturity of only 10 years, planning to then renew them as they expire).
- 47(b) required that the assets are identified and held on accounts or registers and refers to Articles 275 and 276 of the Solvency II Directive. All insurers comply with this requirement, as provided by Article 276 of Solvency II. However, it is not clear why 47(b) included a reference to Article 275 – which deals with the hierarchy of claims.

- 47(c) stated that the claims of retail investors have priority over the claims of other creditors of the PRIIP manufacturer. It should be clarified that an insurer that fulfils either of the following is given an automatic allocation to credit risk measure 2:
  - Article 275(1)(a) of Solvency II, with respect to the precedence of the claims of policyholders over other creditors, and Article 275 (3) and Article 276 of Solvency II in regards the establishment of a special register fulfils the criteria in paragraph 47.
  - Article 275 (1)(b) and 278 of Solvency II and is not in breach of its SCR fulfils the criteria in paragraph 47.

This would ensure a level playing field with manufacturers which are subject to paragraph 46. Therefore, the provisions of Paragraph 47 of Annex II must be clearly explained at Level 3 in order to provide legal certainty, that insurers compliant with Solvency II are automatically classified as credit risk measure 2.

- ➔ *Level 3 should clearly set out that insurers compliant with Solvency II are automatically classified as credit risk measure 2. The CRM should be assigned as 2 where the PRIIP is manufactured by an insurer that is compliant with the provisions of the Solvency II Directive, and in particular Articles 275 and 276 of Solvency II.*

#### ■ Closed business

Insurers still face a high degree of legal uncertainty as to whether a Key Information Document (KID) will be needed for closed business products. The EC stated during the July public hearing that closed book products are out of the scope of the PRIIPs Regulation, including when top-ups and/or switches (including the increase of premiums and fund additions) are made. However, no legal certainty has been provided in the RTS as yet.

- ➔ *Level 3 should clarify that manufacturers should not develop a KID for closed business, including when existing contractual options are exercised, as the KID is a pre-contractual information document as mentioned in Article 5(1) and Article 6(1) of the PRIIPs Regulation.*

#### ■ Treatment of annuities

For the annuities that are in the scope of the PRIIPs Regulation, it remains unclear how the RTS apply, given the particular characteristics of such products.

- ➔ *Level 3 should clarify how the RTS apply for the annuities that are in the scope of the PRIIPs Regulation.*
- ➔ *There should be a clarification that annuities, where a single premium is paid and annuity payments start from the beginning of the contract, should be out of scope since there is no capital accumulation phase. It is not possible to calculate the indicators for these products as demanded in the PRIIPs regulation and the RTS.*
- ➔ *There should be a further clarification that for annuity products with an accumulation phase only the accumulation phase should be considered for the calculation of the indicators. In addition, there should be the possibility in the KID to describe the characteristics of the product, especially the pay-out phase in form of annuities.*

#### ■ Specific information for MOPs underlying options

The information in the generic KID should include information about the overall product, whereas the specific information for underlying options should relate to that option only (and not include information about the overall PRIIP). In this context, information and indicators should relate only to the underlying investment options and should not be aggregated with the information on the overall insurance product itself when it comes to specific information. However, the EC has not provided the legal certainty needed by the sector on this point.

Within some MOPs, the underlying option is meant to be held for the entire holding period. Therefore, for some products, it could 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.

It should be clarified that errors in the information contained in the documents on the underlying investment options do not lead to sanctions against the manufacturer of the insurance product, since this information is not produced by the insurers.

- ➔ *Level 3 should clarify that the specific information for underlying options should not include information related to the overall PRIIP.*
- ➔ *Level 3 should clarify in particular that the statement contained in Recital 18 of the RTS, stating that "In addition, the specific information on the underlying investment options should always reflect the features of the PRIIP through which the underlying investment options are offered.", does not mean that the specific information will need to aggregate the information on the underlying options together with information about the overall product. Recital 18 should mean that - for example - the respective share class of a fund that is offered in a MOP should be described in the information on the underlying investment option.*
- ➔ *Flexibility at Level 3 is necessary to allow holding periods of underlying options to be adjusted to the holding period of the overall MOP.*
- ➔ *Errors in information on underlying options that is not produced by insurers should not lead to sanctions for insurers.*

#### ■ **Transaction costs for insurers**

Insurers face two issues when calculating transaction costs, which in most cases will be marginal. This is particularly true for the security/guarantee assets.

- For some asset classes the necessary historical data is lacking.
  - For some asset classes, such as alternative investments, the current RTS do not provide a methodology at all.
- ➔ *If the necessary historical market data is not available for PRIIPs (this applies not only to new PRIIPs), approximate solutions should be possible for the calculation of transaction costs. Possible ways to achieve this:*
- An extension of methods developed for new PRIIPs in Annex VI (21) RTS to other PRIIPs that do not have all the necessary historical market data.
  - An application of the table with standardised percentages introduced in Annex VI, part 1, 25 of the Joint Consultation Paper JC 2015 073. An additional advantage of this table is that it will rightly yield positive values for transaction costs. According to the current methodology, negative transaction costs are possible and it would be rather difficult for manufacturers to explain them to consumers.

However, neither of these two solutions can cover all investments. In particular, there is no solution for investments where no meaningful market data exists in general, as for alternative investments (e.g. infrastructure investments and real estate). For such investments, the manufacturer should be able to estimate the transaction costs based on the amount of actual identifiable costs directly associated with the transaction.

- Transaction costs are included in the costs for managing capital investments. The total costs for managing capital investments are to be disclosed according to Articles 34 (II) (9)(a) and 42 of the Directive on the annual accounts and consolidated accounts of insurance undertakings (91/674/EEC). The use of these figures should be allowed instead.

Reference	Topic	Issue that needs clarification at Level 3
Article 12 RTS	Insurance benefits of a MOP	It should be clarified how Article 3 (4) RTS applies with regard to the generic information document: In the case of products offering a range of options for investment, the performance of the insurance benefit may depend on the underlying investment option. Therefore, Article 12 RTS should provide for a derogation from Article 3 (4) RTS.
Annex II, 14 RTS	Calculation of Market Risk	<p>Do tactical tilts to strategic weights require that pro-forma historic fund returns be calculated as per point (a)(ii) "the VEV of the returns of the pro-forma asset mix that is consistent with the reference asset allocation of the fund at the time of the computation"? Calculation of the VEV as per (a)(ii) above will require the ability to run back tests on any new asset mix, which could create a significant burden.</p> <p>While Annex IV, point 4 of the amendments state that "the scenario values under different performance scenarios shall be calculated in a similar manner as the market risk measure", there is no reference in the performance scenario methodology to the scenario described in Annex II, part 1, paragraph 14. Is the intention therefore that the approach described in paragraph 14 above does not apply to the calculation of the performance scenarios?</p>
Annex II, 17 RTS	The VaR-equivalent volatility (VEV)	This formula is designed to capture the VEV of single premium investments and does not work for ongoing premiums. It should be clarified how the formula applies for ongoing premiums.
Annex II, 22(c) RTS	Calculating the return	<p>The indication is to calculate the return by summing the different "simulated" returns through bootstrapping during the observed period. For example, if a 2-year holding period is considered with a daily time step (i.e. 260 days x 2 years= 520 returns), for each of the 10,000 simulations with the sum of the 520 daily returns, to calculate the total return over the 2 considered years; however, it may occur that the sum of the 520 daily returns gives a &lt;-100% final return, which does not have any economic nor financial meaning.</p> <p>Will there be any indications or suggestions about how to operate in these cases, for example by applying a -100% floor? In general, a longer holding period corresponds to a higher number of simulations, that could have similar characteristics, i.e. with returns &lt;-100%.</p>
Annex II, 22(c) RTS	Correction for risk-neutrality	<p>Each of the 10,000 simulated returns needs a correction to ensure that the simulated average return is equal to an expected risk-neutral return and to avoid that the simulations follow the implicit drift of the <i>historic row</i>.</p> <ul style="list-style-type: none"> <li>The first issue is with the formula that should be used to calculate the return ("Final value of the return") after the corrections. All the variables of this formula are scalar, which would lead to 10,000 equal returns.</li> <li>The second issue is with the methodology, when applying a correction for risk neutrality, the resulting simulations at the end are only usable for final returns (that appear risk-neutral) but not for the intermediate returns, which means that they are not usable for products where the pay-off is a</li> </ul>

		function of the underlying asset even during the holding period.
Annex V, Part 2 RTS	Insurance premium as part of the total investment	A clarification is needed to show that "investment" means the total payment made by consumer and that "insurance premium" is part of it. Furthermore, the RTS uses the terms "biometric risk premium" and "insurance premium". It should be clarified whether the terms have the same meaning and if so, a consistent approach throughout the RTS should be used.
Annex VI, part 2, 83 RTS	Past cost ratios	There is no added value to presenting the information on the ratios that were applicable during previous years. It is not clear which products this provision applies to and how many past years should be presented. It should be clarified that manufacturers are not obliged to calculate past values before the application of the PRIIPs Regulation, since these values cannot be calculated on an ex-post basis. Furthermore, it is not clear which ratios should be presented.
Annex VII RTS	Invested amount	There are currently products where the maximum invested capital is less than EUR 1,000 a year. On the other hand, products exist with minimum single-premium investment of more than EUR 10,000. Which value for the invested capital should be presented for such products?
Annex III, Annex V, Annex VII RTS	Mandatory text elements	It should be confirmed that the general rule (PRIIPs manufacturers must prepare key information documents that are accurate, fair, clear and not misleading) takes precedence over the detailed rules in the RTS and therefore, if a pre-formulated text element does not suit the product, it could be amended to comply with the general obligation to give accurate and non-misleading information.

Insurance Europe is the European insurance and reinsurance federation. Through its 35 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of €1 200bn, directly employ 985 000 people and invest nearly €9 900bn in the economy.