

Opinion on monetary incentives and remuneration between providers of asset management services and insurance undertakings

1. Legal basis

- 1.1. The European Insurance and Occupational Pensions Authority (EIOPA) provides this Opinion on the basis of Article 29(1)(a) of Regulation (EU) No 1094/2010¹ (the "EIOPA Regulation"). According to this Article, EIOPA shall 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 by providing opinions to competent authorities.
- 1.2. EIOPA delivers this Opinion in the context of its responsibilities to take a "leading role in promoting transparency, simplicity and fairness in the market for consumer financial products or services across the internal market" under Article 9(1) of the EIOPA Regulation, and to "monitor new and existing financial activities" under Article 9(2) of the EIOPA Regulation. Furthermore, under Article 15 of Regulation 1286/2014² (the "PRIIPs Regulation"), EIOPA is required to "monitor the market for insurance-based investment products marketed, distributed or sold in the Union". In addition, under Article 1(5) of Directive (EU) 2016/97³ (the "IDD", Insurance Distribution Directive), EIOPA may facilitate and co-ordinate monitoring by competent authorities of the market for insurance products which are marketed, distributed or sold in, or from, their Member State.

¹ 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).

² Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) (OJ L 352, 9.12.2014, p. 1).

³ Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast) (OJ L 26, 2.2.2016).

- 1.3. Based on the above-referenced EIOPA responsibilities, this Opinion concerns, in particular, consumer protection issues related to monetary incentives and remuneration between providers of asset management services and insurance undertakings.
- 1.4. This Opinion is addressed to National Competent Authorities (“NCAs”), as defined in point (i) of Article 4(2) of the EIOPA Regulation. NCAs are encouraged to increase their level of awareness of and monitoring of the market with regard to the identified risks of consumer detriment and of mitigating measures implemented by insurance undertakings.
- 1.5. The Board of Supervisors has adopted this Opinion in accordance with Article 2(7) of its Rules of Procedure⁴.

2. Context and aim

- 2.1. EIOPA is concerned about insurance undertakings choosing underlying investment vehicles of unit-linked policies (“underlying funds”) on the basis of those which provide the highest level of monetary incentives and remuneration to insurance undertakings.
- 2.2. EIOPA has found such monetary practices to be widespread and significant across the European Union (EU)⁵. As further substantiated below, EIOPA has identified risks of consumer detriment relating to unmitigated conflicts of interest and to how insurance undertakings select and monitor the assets of unit-linked policies.
- 2.3. Existing and upcoming EU law provide for overarching principles such as the duty to always act honestly, fairly and professionally in accordance with the best interests of customers or to take all appropriate steps to prevent, identify, mitigate and manage conflicts of interest. This principle-based approach in EU law, alongside different national regimes regarding monetary practices, leads to insurance undertakings pursuing various business practices which may result in different levels of consumer protection across the EU.
- 2.4. In view of the above, this Opinion aims to promote consistent supervisory practices covering:
- (a) how existing and upcoming EU law applies to conflicts of interest arising from the monetary practices; and

⁴ Decision adopting the Rules of Procedure of EIOPA’s Board of Supervisors, available at: https://eiopa.europa.eu/Publications/Administrative/EIOPA-BoS-11-002_EIOPA-BoS-Rules%20of%20Procedure-Rev3.f.pdf.

⁵ Refer to EIOPA’s Report on thematic review on monetary incentives and remuneration between providers of asset management services and insurance undertakings (EIOPA-BoS-17-064), available at https://eiopa.europa.eu/Publications/Reports/16.%20EIOPA-BoS-17-064-Report_Thematic%20review%20on%20monetary%20incentives%20and%20remuneration.pdf.

(b) the practical application of the principles set out in the IDD and in Directive 2009/138/EC⁶ (the "Solvency II Directive") in managing assets of unit-linked policies.

2.5. It is stressed that the identified market practices and the resulting risks of consumer detriment are not universal. They may not be relevant in certain Member States due, for example, to safeguards under national law, or to market practices and structures which are locally prevalent. In addition, insurance undertakings can take measures that go beyond relevant requirements under national law to ensure that risks do not materialise and do not negatively impact customers.

3. Risks of consumer detriment

3.1. With reference to its legislative remit, EIOPA has conducted a thematic review among 28 EEA countries⁷. Based on the findings, the following five risks of consumer detriment were identified:

- Higher costs for policyholders;
- Information asymmetry/uninformed choices by policyholders;
- Unsuitable product offerings;
- Unsuitable sales and biases in distribution;
- Poor investment outcomes for policyholders arising from:
 - a) Inappropriate selection processes by insurance undertakings;
 - b) Poor governance/systems and controls including monitoring processes and outsourcing of functions.

3.2. The risk of higher costs for policyholders arises from two distinct aspects. Firstly, where not fully rebated to customers, monetary incentives and remuneration received by insurance undertakings may indirectly lead to higher costs for policyholders. Secondly, most unit-linked policies pursue investment objectives and invest in asset classes which carry higher asset management charges.

3.3. Information asymmetry also frequently contributes to consumer detriment. Where monetary practices are not disclosed to policyholders, they would not be able to take them into account when considering which unit-linked policy and which underlying funds to invest in, though information about the practices may be challenging for policyholders to assess. Moreover, the absence of clear disclosure on the nature and criteria used by insurance undertakings for the selection of underlying funds on offer may lead policyholders to assume that insurance undertakings have properly pre-selected propositions that achieve the best consumer outcomes.

3.4. A further issue that often increases the likelihood of consumer detriment is the impact that monetary practices can have on how effectively insurance

⁶ 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 (Solvency II) (OJ L 335, 17.12.2009, p. 1).

⁷ EEA countries excluding Cyprus, Iceland and Norway.

undertakings are adequately selecting underlying funds for policyholders. Where insurance undertakings offer a narrow selection of underlying funds, insurance undertakings will need to apply criteria in making this narrow selection; these criteria must address the adequate selection of underlying funds in accordance with the needs, characteristics and objectives of the identified target market under Product Oversight and Governance requirements. Yet, insurance undertakings tend to offer underlying funds that pay higher levels of monetary incentives which tend to pursue similar investment objectives and invest in a similar range of asset classes. A selection of underlying funds that is determined by levels of monetary incentives would likely fail to be in accordance with the needs, characteristics and objectives of the identified target market.

- 3.5. Related to unsuitable product offerings, but raising additional issues, is the risk that remuneration schemes for sales staff mirror the levels of incentives received from asset managers, thus promoting at the point of sale the distribution of products which provide a higher level of monetary incentives for insurance undertakings. This could distort the quality of the distribution and be a driver of unsuitable sales to policyholders.
- 3.6. Furthermore, EIOPA found issues where insurance undertakings are managing the assets of unit-linked policies in ways that may not lead to good consumer outcomes. Selecting the most relevant or competitive underlying funds in the structuring of unit-linked policies is part of the insurance undertaking's duty to act in the best interests of customers. Positive consumer outcomes may also be at risk if insurance undertakings apply inadequate oversight of their service providers as a result of inadequate or deficient procedures to monitor the selected underlying funds and asset managers and to replace them, where appropriate.

4. Assessment of how existing and upcoming EU law addresses the risks of consumer detriment

- 4.1. Existing and upcoming EU law – the IDD, the Solvency II Directive and the Commission Delegated Regulation (EU) 2017/653⁸ (the “PRIIPs KID Regulation”) – includes general principles that apply to the identified risks of consumer detriment, which are the basis for measures to be taken by insurance undertakings to safeguard the interests of customers.
- 4.2. Regarding the conflicts of interest resulting from the existence of monetary incentives, the IDD requires insurance undertakings to always act honestly, fairly and professionally in accordance with the best interests of their customers⁹ and

⁸ Commission Delegated Regulation (EU) 2017/653 of 8 March 2017 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs) by laying down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents (OJ L 100, 12.4.2017, p. 1).

⁹ Article 17(1) of the IDD.

to take all appropriate steps to prevent, identify, mitigate and manage conflicts of interest¹⁰. The principles set out in the IDD should be used as the basis for measures or actions to be taken by insurance undertakings to manage the conflicts of interest such as, for instance, measures to rebate the monetary incentives received from asset managers to policyholders or measures to consider the cost and value proposition of the selected underlying funds being offered to policyholders.

- 4.3. The Solvency II Directive contains general principles regarding the management of assets of unit-linked policies. Specifically, the Prudent Person Principle provides that the whole portfolio of assets of insurance undertakings has to be invested in the best interests of customers¹¹. Furthermore, the Solvency II Directive imposes robust governance and oversight requirements for outsourced functions¹². In addition, when designing and marketing unit-linked policies, insurance undertakings must ensure that these products are compatible with the needs, characteristics and objectives of the target market¹³. These principles should be applied in practice, for instance, regarding the selection of underlying funds and asset managers and regarding the ongoing monitoring when assets are managed by third parties.
- 4.4. Regarding the disclosure of information to policyholders, while it is not specified in what manner information on all costs and charges is provided to customers, insurance undertakings are required to provide such information, including any third party payments¹⁴. Furthermore, the PRIIPs KID Regulation specifies in detail, among other things, how overall costs and certain elements of these costs are disclosed for purposes of comparisons, although not including a separate disclosure of any payments of monetary incentives or remuneration between asset managers and undertakings. This may leave customers unaware of whether or not there are any such payments. Moreover, the non-disclosure of the nature and criteria used in the insurance undertakings' selection process for the underlying funds on offer increases the risk of information asymmetries leading to uninformed choices.
- 4.5. The risks of unsuitable product offerings and of unsuitable sales and biased distribution should be mitigated by the Product Oversight and Governance requirements under the IDD. Insurance undertakings are required to identify target markets for their products and continuously monitor and review insurance

¹⁰ Articles 27 and 28 of the IDD.

¹¹ Article 132 of the Solvency II Directive. This is also confirmed by Guideline 32 of the EIOPA Guidelines on the System of Governance, available at: https://eiopa.europa.eu/GuidelinesSII/EIOPA-BoS-14-253_GL%20on%20system%20of%20governance.pdf.

¹² Article 49 of the Solvency II Directive. EIOPA further developed those through Section 11 of the EIOPA Guidelines on the System of Governance.

¹³ Article 25(1) of the IDD and Article 5 of the Commission Delegated Regulation (EU) .../... of 21.9.2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to product oversight and governance requirements for insurance undertakings and insurance distributors (C(2017) 6218 final), as endorsed by the European Commission.

¹⁴ Article 29(1)(c) of the IDD.

products and take appropriate action to mitigate any circumstances that may adversely affect the customer of the product¹⁵. In addition, under the IDD's rules on inducements, insurance undertakings must perform an overall analysis to assess whether an inducement has a detrimental impact on the quality of the relevant service to the customer¹⁶.

5. Taking the above into consideration, EIOPA is of the Opinion that

5.1. NCAs should be reminded that both the IDD and Solvency II set out principles for insurance undertakings to act in accordance with the best interests of their customers. The principles apply to conflicts of interest, including those resulting from monetary incentives received from asset managers and to how the assets of unit-linked policies are managed. The fact that assets of unit-linked policies are managed by third parties does not discharge insurance undertakings from this duty.

5.2. NCAs should take the necessary and proportionate supervisory actions to:

5.2.1. Emphasise to insurance undertakings that monetary incentives received from asset managers may be a source of conflicts of interest and that appropriate steps to prevent, identify, mitigate and manage the resulting conflicts of interest should be taken, considering the principles set out in the IDD.

5.2.2. Provide guidance to insurance undertakings on possible organisational or administrative arrangements to prevent conflicts of interest from adversely affecting the interests of policyholders, such as the rebating of monetary incentives received from asset managers to policyholders. Where insurance undertakings disclose the monetary practices as a measure of last resort, customers should be provided with appropriate information regarding the general nature or source of the conflicts of interest prior to concluding the contract, including the nature of the monetary incentives received or, where that is not possible, the necessary information for evaluating the structure of the monetary incentives.

5.2.3. Provide guidance on measures to manage assets of unit-linked policies in the best interest of policyholders considering the principles set out in the IDD and Solvency II. In particular, NCAs should ensure that insurance undertakings have adequate processes for selecting, monitoring and reviewing asset managers and underlying funds and for taking appropriate corrective action such as replacing asset managers and underlying funds. These processes should be regularly reviewed to ensure they remain adequate and up-to-date.

¹⁵ Article 25(1) of the IDD and Articles 5 and 7 of the Commission Delegated Regulation (EU) .../... of 21.9.2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to product oversight and governance requirements for insurance undertakings and insurance distributors (C(2017) 6218 final), as endorsed by the European Commission.

¹⁶ Article 29(2) of the IDD and Article 8 of the Commission Delegated Regulation (EU) .../... of 21.9.2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to information requirements and conduct of business rules applicable to the distribution of insurance-based investment products (C(2017) 6229 final), as endorsed by the European Commission.

5.2.4. Ensure that customers are provided with appropriate information on the nature and criteria used by insurance undertakings for the selection of underlying funds on offer.

5.3. Within six months of the latest application date of any of the following legal acts – the IDD, the PRIIPs KID Regulation, the Product Oversight and Governance Delegated Regulation (C(2017) 6218 final) or the IBIPs Delegated Regulation (C(2017) 6229 final) – NCAs are requested to provide feedback on regulatory or supervisory actions taken on the basis of this Opinion and to report to EIOPA if and how domestic market practices have evolved.

5.4. This Opinion will be published on EIOPA's website.

Done at Frankfurt am Main, 29 November 2017

[signed]

Gabriel Bernardino

Chairperson

For the Board of Supervisors