EIOPA-BoS-17-064
26 April 2017

Report on

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

EIOPA – Westhafen Tower, Westhafenplatz 1 - 60327 Frankfurt – Germany - Tel. + 49 69-951119-20;
Fax. + 49 69-951119-19; email: info@eiopa.europa.eu site: www.eiopa.europa.eu

Table of contents

Executive summary

This Report sets out the findings of EIOPA's EU-wide thematic review of consumer protection issues in the unit-linked market emerging from the business interlinkages between providers of asset management services and insurance undertakings.

The **thematic review focuses specifically on sources of potential consumer detriment resulting from the existence of monetary incentives and remuneration received or obtained by insurance undertakings from in-house or external asset managers** responsible for managing the assets of unit-linked funds.

The central key issue to the thematic review is to establish the existence, magnitude and structure of monetary incentives and remuneration (Issue A). However, **an in-depth analysis of two other key issues allows EIOPA to gain a better understanding of what is working, what is not working, possible root causes and impacts to consumers**. The deeper understanding will allow for a better definition of any necessary additional work or policy work to be developed in view of achieving appropriate levels of consumer protection.

The key issues considered in the thematic review are as follows:

A. Existence, magnitude and structure of monetary incentives and remuneration;

B. Way in which insurance undertakings structure their unit-linked products;

C. Measures taken or not taken by insurance undertakings to address conflicts of interest and act in the best interests of customers.

Issue B considers if and how the existence of monetary practices impacts how the assets of unit-linked products are managed (e.g. types and characteristics of the underlying investment vehicles selected by insurance undertakings, the prevailing asset management arrangements) and how this shapes the offering to policyholders.

Issue C assesses how insurance undertakings manage and mitigate conflicts of interest emerging from these monetary practices, specifically considering measures around disclosure and rebating to policyholders monetary incentives and remuneration received. Furthermore, the policies that insurance undertakings have in place to act in the best interests of customers regarding how the assets of unit-linked products are managed and the offering to policyholders are also considered.

Evidence was collected with reference to the year 2015 from **218 insurance undertakings operating in 28 Member States**[1] and a sample of more than **1,800 underlying investment vehicles** used by insurance undertakings in the structuring of unit-linked funds. Participating insurance undertakings represent

[1] EEA Member States excluding **CY, IS** and **NO**.

circa **70% of the unit-linked market** measured by assets under management as at 31.12.2014.

The **flows of remuneration considered are exclusively monetary incentives and remuneration received or obtained by insurance undertakings from providers of asset management services**. Remuneration involving other entities such as monetary incentives between insurance undertakings and intermediaries is not within the scope of the thematic review. Likewise, monetary incentives and remuneration of the undertakings' sales/frontline staff (those that are policyholder facing) are not within the scope of the thematic review. It is also not within scope of the thematic review to investigate in detail how insurance undertakings used the monetary incentives and remuneration received, other than if these were rebated in part or wholly to policyholders.

Main findings

The thematic review found that **monetary practices are widespread and significant**. It provides evidence for concluding in general that poor or inconsistent mitigation of conflicts of interest could lead to material consumer detriment. In addition, the in-depth analysis of how insurance undertakings manage the assets of unit-linked funds revealed **significant inconsistencies and potential issues with the selection and monitoring of assets**.

The **main findings** of the thematic review, for each of the key issues, were:

A. Existence, magnitude and structuring of monetary practices

- Monetary practices are widespread in the industry: **81% of participating insurance undertakings received monetary incentives and remuneration** from asset managers;

- Monetary incentives and remuneration received by participating insurance undertakings **totalled EUR 3.7bn in 2015**. The estimate for the **entire market is EUR 5.2bn in 2015**;

- For those undertakings that engage in these monetary practices, monetary incentives and remuneration received represent a median value of **0.56% of assets under management and 46% of fund management charges**;

- Monetary incentives are **predominantly recurring in nature**.

B. Structuring of unit-linked products

- Less than **3% of unit-linked assets are directly managed by insurance undertakings**; **in-house asset managers** (belonging to the same group as the insurance undertaking) manage **69% of assets**; **external asset** managers manage **28% of assets but pay almost 50% of total remuneration**;

- **Investment structures and asset management arrangements are relatively simple** with insurance undertakings using a limited number of asset managers and investment vehicles (in most cases one in-house asset manager and around 8 external asset managers);

- Insurance undertakings **invest a significant proportion of unit-linked assets in funds that pay higher levels of monetary incentives and remuneration** (e.g. almost 60% of assets are invested in funds that pursue an active investment strategy; 63% of funds are equity or multi-asset funds);

- In many instances, **insurance undertakings operate, in respect of the units offered in unit-linked contracts, as *de facto* distributors** of pooled funds, with no significant divergence (at the level of the units) between units offered and funds used to underlie them;

- Most unit-linked funds offered are equity or multi-asset funds and most pursue an active investment strategy.

C. Addressing conflicts of interest & acting in the best interests of customers

- Insurance undertakings generally **have formal policies to ensure that they act in the best interests of customers**, with specific reference to conflicts of interest that might arise in the course of unit-linked business. However, **actual practices under these formal policies vary significantly**;

- **69% of undertakings do not disclose** monetary incentives and remuneration received to policyholders;

- **61% of undertakings retain** monetary incentives and remuneration received;

- **25% of undertakings pass on, in full, to the policyholder** monetary incentives and remuneration received; this represents 30% of total monetary incentives received;

- The **selection of asset managers and investment vehicles does not always follow a comprehensive process**. The selection is, in some cases, **constrained by existing business relationships with asset managers**;

- **25% of insurance undertakings do not have a formal process for selecting investment vehicles** while **32% do not have monitoring processes**. In these cases they tend to delegate these responsibilities to asset managers.

Sources of potential consumer detriment

The evidence gathered for the thematic review has been used to identify several sources of potential consumer detriment. These are summarized below.

These are **not intended to be exhaustive or universal**. Sources of potential consumer detriment may not be relevant in certain Member States, for example due to the nature of the legal framework or generalised market practices and structures. Also, the **extent to which these sources of potential consumer detriment may materialise and negatively impact individual customers depends on the specific measures taken or not taken by individual insurance undertakings**. In addition, the relative primacy of these different sources of potential consumer detriment has not been assessed in detail here, but **may vary according to the situation in certain Member States**.

No or poor disclosure

- Where monetary practices are not disclosed, customers may fail to take this into account when considering which unit-linked product to invest in;
- Disclosures of a general kind may not provide sufficient information for the policyholder to consider the potential impact of the monetary practice;
- The absence of clear disclosure on the nature and criteria used within the insurance undertaking's selection process may lead consumers in some cases to draw a wrong conclusion on that process, for instance that the undertaking has pre-selected the most relevant or "good value" propositions for them.

Cost to policyholders

- Monetary incentives and remuneration retained by insurance undertakings may indirectly lead to higher costs.

Poor investment outcomes

- Choosing underlying investment vehicles on the basis of those which provide the highest level of monetary incentives and remuneration may lead to not choosing the most relevant or competitive investment vehicles;
- Using a reduced number of asset managers may lead to not choosing the most relevant or competitive investment vehicles; it is highly unlikely that a single asset manager will provide relevant funds across the entire range of asset classes or be able to uniformly outperform its peers;
- The lack of formal processes for the selection, monitoring and replacing of asset managers and investment vehicles puts at risk the potential to use the most relevant or competitive investment vehicles in the structuring of unit-linked funds.

Reduced and unsuitable offering

- Choosing underlying investment vehicles on the basis of those which provide the highest level of monetary incentives and remuneration may limit the choice of products to policyholders.

Introduction and outline of the Report

Motivation for selected topic

The motivation for launching a thematic review on monetary incentives and remuneration between providers of asset management services and insurance undertakings stems mainly from two considerations. On the one hand, **the importance of insurance-based investment products**, in particular unit-linked life insurance products (hereafter "unit-linked products" or "unit-linked funds") and, on the other hand, EIOPA's duty to investigate current and emerging risks to consumer protection.

National Competent Authorities (NCAs) have noted, in the context of the preparation of EIOPA's annual Consumer Trends Report, such **risks arising in regards to unit-linked products**, and the specific relations between insurance undertakings and asset managers have been identified as a key potential area to examine.

Objective of the Report

This Report presents the results of **EIOPA's in-depth gathering of evidence on business interlinkages between providers of asset management services and insurance undertakings, and potential impacts for consumers**. More specifically, how monetary incentives and remuneration received or obtained by insurance undertakings from in-house or external asset managers responsible for managing the assets of unit-linked funds can lead to conflicts of interest that, if unmitigated may, ultimately, be sources of potential consumer detriment.

In view of this, the thematic review is focused on **gathering data on the extent, nature and impact of monetary incentives and remuneration between asset managers and insurance undertakings**. Most importantly, this analysis will allow quantifying the level of monetary incentives and remuneration.

In addition, the thematic review considers **the choices made by insurance undertakings regarding the management of unit-linked assets** by looking at who manages the assets of unit-linked funds and at what asset managers, investment vehicles, investment strategies and asset classes are used. The purpose is to **assess how these choices may potentially impact consumers**. Consumers are impacted by the characteristics of the underlying investment vehicles selected by insurance undertakings at the level of the risk-return spectrum but also in so far as these funds are used to structure the undertakings' offering of unit-linked products.

A third and final element considered in the thematic review is **how insurance undertakings address and mitigate the emerging conflicts of interest and act in the best interests of customers**.

If unmitigated, the potential conflicts of interest emerging from the business interlinkages with providers of asset management services may seriously undermine the workings of the market and result in consumer detriment.

Accordingly, the thematic review surveys the measures taken by insurance undertakings, including disclosures of these practices and rebating of economic benefits to policyholders. The thematic review looks at how insurance undertakings seek to act in the best interests of customers and considers how insurance undertakings generally apply this principle in the selection and managing of the assets of unit-linked funds and customer offerings.

Note that the **sources of potential consumer detriment** highlighted in the Report are **not intended to be exhaustive or universal**. Sources of potential consumer detriment may not be relevant in certain Member States, for example due to the nature of the legal framework or generalised market practices and structures. Also, the **extent to which these sources of potential consumer detriment may materialise and negatively impact individual customers depends on the specific measures taken or not taken by individual insurance undertakings**. In addition, the relative primacy of these different sources of potential consumer detriment has not been assessed in detail here, but **may vary according to the situation in certain Member States**.

Sample & data sources

Evidence was collected from a **highly representative and controlled sample of 218 insurance undertakings operating in 28 Member States**[2] with reference to the year 2015. Most participating insurance undertakings (184) provided responses with reference to the activities undertaken in their home market while the remaining responses where from participants undertaking business cross-border under the freedom of establishment or freedom to provide services principles.

Participating insurance undertakings represented circa 70% of the unit-linked market measured by assets under management as at 31.12.2014. The sample is mostly composed of the largest domestic insurance undertakings in each Member State.

In addition, granular data was collected for a sample of **more than 1800 investment vehicles used by insurance undertakings** in the structuring of unit-linked funds. These investment vehicles are the largest ones used by each insurance undertaking, i.e., the upper quartile of investment vehicles used by each insurance undertaking, up to a maximum of 10 investment vehicles, measured by the market value of holdings at 31 December 2015. **Annex III** provides further details of the sample of participants.

The primary data source of the thematic review was an extensive industry questionnaire distributed by NCAs to the participating insurance undertakings which covered both quantitative and qualitative elements. Quantitative aggregate market data covering elements such as the number of insurance undertakings operating in each market, number of contracts, gross written premiums and assets under management was reported by NCAs. **Annex I** provides further details on the methodology while **Annex IV** provides an overview of the industry questionnaire.

[2] EEA Member States excluding **CY**, **IS** and **NO**.

Outline of the Report

The Report is structured as follows.

The **background section** presents reported consumer protection issues that have motivated this thematic review, EIOPA's tasks, powers and objectives and the relevant legislative framework under which insurance undertakings and providers of asset management services operate.

The section on the **scope of the thematic review** provides further details on the three key issues and other elements considered in scoping the thematic review: flows of remuneration included and excluded, types of monetary incentives and remuneration within scope and the life insurance products considered.

The **following three sections comprise the core of the Report**. They present, for each of the three key issues addressed, the results of the evidence gathered and discuss sources of potential consumer detriment that may be derived from the fact-finding exercise.

The **annexes to the Report provide further detail** on the methodology, the industry questionnaire and other elements of the analysis carried out. Information of the European unit-linked market and the sample of participating insurance undertakings is also presented. Finally, the annexes also include a glossary and the listing of abbreviations, tables and figures.

Background

Unit-linked life insurance products are a popular offering by life insurance undertakings that allow policyholders to channel all or a large part of the premiums paid into pooled investment vehicles. The collective nature of unit-linked products allows policyholders to combine their capital along with other policyholders', giving the opportunity to invest in a wider range of investments than if investing on their own.

In addition to the investment component, unit-linked products may also offer, under a single integrated plan, insurance cover[3] to the policyholder.

Unit-linked products **facilitate access to a wide range and types of assets and investment strategies**, which are suitable to different consumer needs, be that saving for retirement or for anticipated future expenditures (e.g. education, mortgage repayment, etc.) or for investment purposes. As with collective investment schemes, in addition to diversification benefits, costs will be lower than if consumers sought to replicate the investments directly themselves by buying and selling individual assets.

The **range of investment choices has grown significantly in recent years** and unit-linked products are now perceived as alternatives to other pooled investment products offered by entities other than insurance undertakings. The wider offering has resulted from the trend to provide unit-linked funds linked to or styled as externally managed funds (i.e. funds managed by external asset managers but offered by insurance undertakings) as a complementary offering to internally managed funds.

The insurance sector is the largest institutional investor in the EU, with almost EUR 9.9tr of assets under management in 2015[4] with **assets of unit-linked funds estimated to total EUR 2.45tr**[5]. At the EU level, this represents circa 40% of all assets held by life insurance undertakings.

By end 2015 there were nearly 780 insurance undertakings (life and composite insurance undertakings) taking up unit-linked business in the EU. This number has been decreasing at a steady pace since 2010, with an estimated number of just above 850 insurance undertakings operating then. These insurance undertakings have collected **in 2015 a total of EUR 277m in gross written premiums** which represents an annual average growth rate of 8.0% during the 2010-2015 period. **Annex II** provides further details on the European unit-linked market.

[3] E.g.: Life cover, guaranteed insurability options, critical illness, disability, health, long-term care, redundancy, depending on local licensing regulation.

[4] Source: Insurance Europe - European Insurance in figures – 2015 data, December 2016; available at http://www.insuranceeurope.eu/sites/default/files/attachments/European%20Insurance%20in%20Figures%20-%202015%20data.pdf.

[5] Source: Data collected by Nacional Competent Authorities for the purpose of the thematic review. Data for **BG, ES** and **NO** refers to 2014; Data for **MT** is based on sample size. Data for **LV** is not included at NCA's request for confidentiality reasons.

Reported consumer protection issues relating to unit-linked products

The **growth of the unit-linked market is not without risks for consumers**, in particular considering the increase in the complexity of such products and the fact that consumers bear, completely or partially, the investment risk.

EIOPA's **Consumer Trends Reports**[6] **have identified several consumer protection issues relating to unit-linked products**. The Reports highlight situations where consumer detriment arises from consumers being provided with misleading or inadequate information about the (potential) benefits, risks and level of guarantees (if any) of these products. This is particularly relevant when consumers have been incentivised to change from guaranteed products to products with lower or no guarantees. There have also been reported situations of insufficient disclosure of some costs and charges of unit-linked products, such as product negotiation fees, charges for acquisition costs or early redemption charges.

In addition, and most relevant to this thematic review, some NCAs also highlighted possible conflicts of interest arising from the selection of the underlying investment vehicles in the structuring of unit-linked products. **NCAs were concerned that insurance undertakings chose underlying investment vehicles on the basis of those which provide the highest level of monetary incentives and remuneration** to insurance undertakings. Such monetary practices raise concerns around **potential conflicts of interest, which if unmitigated could seriously undermine the workings of the market, and thus result in consumer detriment**. This could be through higher costs and/or lower quality of products offered, or via incentives on sales, mis-selling (mismatches between consumer demands needs and specific investments sold or recommended).

EIOPA's tasks, powers and objectives

Legal basis

One of EIOPA's primary tasks in the area of consumer protection is to **take a "leading role in promoting transparency, simplicity, accessibility and fairness in the market for consumer products and services across the internal market"** by "collecting, analysing and reporting on consumer trends".

Furthermore, EIOPA is also required to "monitor new and existing financial activities" (Article 9 of the EIOPA Regulation[7]). To achieve its tasks, EIOPA has been given powers listed under Article 8(2) of the same Regulation, in particular, the power to "develop common methodologies for assessing the effect of product characteristics and distribution processes on the financial position of institutions and on consumer protection".

---

[6] Reports available at https://eiopa.europa.eu/publications/reports. E.g. EIOPA Fourth Consumer Trends Report, page 24, available at https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-15-233%20-%20EIOPA_Fourth_Consumer_Trends_Report.pdf.

[7] Regulation 1094/2010 Of the European Parliament and of the Council of 24 November 2010; available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0048:0083:EN:PDF.

An in-depth investigation into the unit-linked market is also aligned with the **requirement under the PRIIPs Regulation**[8] for EIOPA to "monitor the market for insurance-based investment products marketed, distributed or sold in the Union" (Article 15) and, in the event that the activity poses a serious threat to the stability and effectiveness of the financial system that could directly affect consumers, issue a warning or temporarily restrict or prohibit products with certain characteristics in the EU (Article 16).

EIOPA's strategic approach to conduct of business supervision and use of thematic reviews

EIOPA has developed a comprehensive risk-based and preventive framework for conduct of business supervision[9]. This framework relies on several tools to soundly analyse data/information on a holistic basis to enable early action to be taken and, thus, prevent widespread consumer detriment.

Thematic reviews are an essential cornerstone of this framework and represent a valuable tool in achieving EIOPA's goals. They allow, through in-depth analysis, assessments to be made of current or emerging risks of consumer detriment or barriers to the effective functioning of the single market. By investigating specific key issues with relevant products and activities in detail, they provide guidance and evidence for reasoned policy proposals and consistent supervisory practices.

Thematic reviews by EIOPA have an embedded EU-wide focus. They are **intended to be used to investigate issues that go beyond one national market**, either because the issues have been identified in several national markets or because they have a cross-border element to them. This facilitates building a coordinated understanding across the markets where issues have been identified and, furthermore, an assessment and "early warning" of the potential for these issues to develop in other Member States.

The thematic review that is the subject of this Report has, in accordance with this broad strategy, been designed to provide a basis for an in-depth analysis of relations between insurance undertakings and asset managers in the specific context of monetary incentives and remuneration, to better identify sources of potential consumer detriment and investigate what would be needed to ensure that consumers are treated fairly. This would be consistent with the key principles of EIOPA's framework for conduct of business supervision: (i) risk-based, i.e. identifying the depth and scale of issues and focussing priorities and resources where they matter most, and (ii) preventive, i.e. anticipating consumer detriment early, rather than just reacting following the emergence of problems.

---

[8] Regulation 1286/2014 of the European Parliament and of the Council of 26 November 2014; available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R1286&qid=1450195857264&from=EN.

[9] Available at https://eiopa.europa.eu/Publications/Reports/EIOPA-16-015_EIOPA_Strategy_on_Conduct_Supervision_Framework.pdf.

Regulatory framework

Interaction of regulatory regimes

The current legislative framework under which insurance undertakings and providers of asset management services operate is highly complex. It is not the purpose of the thematic review to address issues concerning the functioning of securities markets, but rather to gather evidence in respect of some aspects of the conduct of insurance undertakings in relation to asset managers, to identify potential areas of concern from a consumer protection standpoint.

It should be noted however that **different legal frameworks**[10] **might apply to insurance undertakings and to asset managers**, with obligations varying according to the nature of the service or product offered and the entities involved.

MiFID II sets out requirements for investment firms to take appropriate steps to identify and prevent conflicts of interest that may adversely affect the interests or have a negative impact on consumers, including those caused by the receipt of inducements from third parties or by the investment firm's own remuneration and other incentives structures[11]. MiFID II also restricts the possibility for firms to receive or pay inducements providing the conditions for the reception or payment of inducements. The new MiFID framework further restricts the possibility for firms providing the service of investment advice on an independent basis and the service of portfolio management to accept and retain fees, commissions or any monetary non-monetary benefits from third parties (and particularly from issuers or product providers). This implies that (*inter alia*) all fees, commissions and monetary benefits paid or provided by a third party must be returned in full to the client after receipt of those payments by the firm.[12]

The UCITS Directive and the AIFMD contain similar provisions concerning conflicts of interest arising from business relationships with third parties other than the UCITS/AIF and inducements paid to or received from third parties other than the UCITS/AIF.

In the context of insurance undertakings using the products or services of asset managers for the purpose of providing investments to policyholders, the insurance undertaking may be seen as a "professional client"[13] of the asset manager, such that the asset manager may view conflicts of interest solely in view of the interests of the insurance undertaking (rather than the interests of underlying policyholders).

In respect of insurance undertaking whose customers are clearly the policyholders, legislation related to insurance and insurance mediation is particularly relevant. The Insurance Mediation Directive (IMD) does not regulate the activity of insurance mediation when undertaken by an insurance

[10] The Solvency II Directive, the Insurance Distribution Directive (IDD), the Markets in Financial Instruments Directive (MiFID), the Undertakings for the Collective Investment in Transferable Securities Directive (UCITS) or the Alternative Investment Fund Managers Directive (AIFMD).

[11] Article 23(1), MiFID II (complemented by Articles from 33 to 43 of MiFID II EC Delegated Regulation, not yet published in the Official Journal).

[12] Article 24(7)(8)(9), MiFID II (complemented by Articles from 11 to 13 of MiFID II EC Delegated Directive, not yet published in the Official Journal).

[13] See reference to "insurance companies" as professional clients of an investment firm under Annex II, 1(1)(d), MiFID II.

undertaking or an employee of an insurance undertaking who is acting under the responsibility of the insurance undertaking[14].

Conversely, the IDD (which entered into force on 23 February 2016 and has to be transposed into national law by 23 February 2018) captures, in its scope, the activities of insurance undertakings when directly selling to policyholders. As such, **the IDD sets stringent provisions for insurance undertakings, when carrying out insurance distribution, to act honestly, fairly and professionally in accordance with the best interests of their customers**[15]. It may be inferred from this general principle that insurance undertakings, acting in the best interests of customers should be careful in mitigating potential harm to customers from any remuneration or monetary incentives being received from asset managers.

In connection with the distribution of any insurance product, insurance undertakings may not be remunerated or remunerate or assess the performance of their employees in a way that conflicts with their duty to act in accordance with the best interests of their customers. In particular, an insurance undertaking may not make any arrangement by way of remuneration, sales targets or otherwise that could provide an incentive to itself or its employees to recommend a particular insurance product to a customer when the insurance distributor could offer a different insurance product which would better meet the customer's needs[16].

When carrying on the distribution of insurance-based investment products, insurance undertakings need to maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest from adversely affecting the interests of their customers[17], in particular those conflicts of interest between themselves and their customers[18].

Specifically regarding inducements, insurance undertakings may only receive or pay fees, commissions or non-monetary benefits from or to third parties in connection with the distribution of insurance-based investment products if such payments do not have a detrimental impact on the service received by the customer and does not impair compliance with the duty to act in the customer's best interests[19].

Specific existing measures by Member States

In preparing this Report, EIOPA has gathered information on specific national legal provisions explicitly regarding monetary incentives and remuneration between providers of asset management services and insurance undertakings. These **do not appear to be widespread**. Applicable regulation regarding the monetary practices under review may be found in general provisions for the

[14] Article 2(3)(2), IMD.

[15] Article 17(1), IDD.

[16] Article 17(3), IDD.

[17] Article 27, IDD.

[18] Article 28, IDD.

[19] Article 29(2), IDD.

management of conflicts of interest and application of MiFID rules**. Nonetheless, some NCAs have issued enhanced regulation**.

For instance, in **BE**, since May 2015, the MiFID rules on conduct of business have been expanded to include the insurance sector (**AssurMiFID rules**[20]). These regulate the types of fees, commissions and inducements which are authorized and include a requirement on disclosure of monetary incentives and remuneration between providers of asset management services and insurance undertakings.

Specific rules regarding how remuneration received from asset managers is passed on by insurance undertakings to unit-linked policyholders apply in **DE**. Insurance undertakings calculate, on an annual basis, the income surplus generated from different sources (risk result, investment result and other income result), a proportion of which is allocated to profit participation. Remuneration received from asset managers is usually captured under other income which has a minimum allocation of 50% to policyholders. This amount is not automatically distributed to individual policyholders at once but is allocated to a provision for bonuses and rebates that usually must not be used for other purposes than profit participation of policyholders. This provision is usually used to smooth profit participation. The actual profit participation of each contract in each year is decided by insurance undertakings.

In **IE**, insurance undertakings adhere to the principles set out in the Consumer Protection Code[21], which includes a provision for acting in the best interests of customers and seeking to avoid conflicts of interest.

Furthermore, in **IT**, there is a requirement for insurance undertakings to identify the cases in which contractual conditions agreed upon with third parties conflict with the interests of policyholders. The provisions also state that policyholders should benefit, directly or indirectly, from any revenues obtained from the rebate of commissions or other revenues received from insurance undertakings in virtue of agreements with third parties[22].

Voluntary industry and consumer initiatives

Voluntary industry initiatives[23] addressing conflicts of interest, disclosure of monetary practices or rebating to policyholders monetary incentives and remuneration received or obtained **are scarce**. Voluntary industry-wide initiatives are reported only in **LU** where there is a Life Insurance Charter of Quality[24] which contains a high-level principle regarding the primacy of clients' legitimate interests.

No consumer initiatives, such as initiatives from consumer associations have been reported by NCAs, which may hint to consumer organizations focusing on

[20] Available at http://www.fsma.be/fr/Supervision/MiFID/instrumentsassurmifid/programsasurmifidvo.aspx.

[21] Available at http://www.centralbank.ie/CONSUMER/CPC/Pages/home1.aspx.

[22] Regulation N. 35 of 26 MAY 2010; available at http://www.ivass.it/ivass_cms/docs/F26396/Reg.%20n.%20%2035%20amended.pdf.

[23] Voluntary industry initiatives include any industry-wide voluntary initiatives supplementing existing regulatory requirements.

[24] Available at http://www.aca.lu/wp-content/uploads/ACA_Charter-of-Quality-2.0_EN.pdf.

other topics or, to a lack of awareness of these practices by consumers or their representatives.

Scope

Key issues

The consumer protection issues reported to EIOPA, the input provided by EIOPA Members as well as EIOPA's own internal assessment have provided guidance to the key issues and working hypothesis that the thematic review considered in detail.

These sit in three areas:

A. Existence, magnitude and structure of monetary incentives and remuneration;

B. Ways in which insurance undertakings structure their unit-linked products;

C. Measures taken or not taken by insurance undertakings to address conflicts of interest and act in the best interests of customers.

The focus of this Report is thereby on gathering evidence in these three areas.

The **sources of potential consumer detriment arise from the business interlinkages between providers of asset management services and insurance undertakings**. Specifically, how the existence of monetary incentives and remuneration received or obtained by insurance undertakings from asset managers can lead to conflicts of interest that are not appropriately mitigated.

The **three issues indicated are linked** and, **taken together, allow EIOPA to have a better understanding of what is working, what is not working, possible root causes and overall impact for consumers**. The deeper understanding will allow for a better definition of any necessary additional work or policy work to be developed in view of achieving appropriate levels of consumer protection.

A. Existence, magnitude and structure of monetary incentives and remuneration

Establishing the existence of monetary incentives and remuneration is not sufficient to fully assess possible levels of consumer detriment.

A meaningful assessment of possible consumer detriment and any subsequent risk-based policy work requires a **quantification of these monetary practices and an understanding of their structuring** (contractual formalisation, characteristics, drivers, etc.). These elements are fully reflected in this Report.

B. Structuring of unit-linked products

As further detailed in the Report, when structuring unit-linked products, insurance undertakings have a range of options regarding how the assets of unit-linked funds are managed.

The thematic review considers **if and how the existence of monetary practices may impact the types and characteristics of the underlying investment vehicles selected by insurance undertakings**. The working hypothesis is that if insurance undertakings seek to maximise remuneration received, and remuneration received is normally a proportion of fund management charges, insurance undertakings could be inclined to select underlying funds whose investment strategies imply higher fund management charges (e.g. riskier asset classes such as equity and funds that pursue an active investment strategy.)

The thematic review also considers the **choices of the insurance undertaking over what to offer through unit-linked products, and how these choices may potentially impact consumers**[25]. Specifically, the thematic review considers the decisions taken by insurance undertakings regarding: (i) who manages the assets of unit-linked funds (insurance undertaking directly, in-house or external asset managers), (ii) type of investment vehicles (pooled funds or segregated portfolios) and (iii) asset classes used and investment strategy (active vs. passive investment management). This will allow gaining a **better understanding of some of the potential drivers of monetary practices**.

Consumer detriment issues relating to the structuring of unit-linked products could be more significant in those situations where insurance undertakings have their own in-house asset manager(s). If insurance undertakings have an incentive to use in-house asset manager(s) rather than external asset managers, questions may arise as to how effectively they are able to ensure they are always acting in the best interests of customers, i.e. choosing the most relevant or competitive investment vehicles and providing appropriate choice or targeting of offers to policyholders. Initial estimates provided by some NCAs were indicative that funds managed within the same financial group are significant[26].

Although preliminary indications were that monetary practices could be more prominent in situations where insurance undertakings use pooled funds, insurance undertakings can instead use in-house or external asset managers to manage segregated portfolios for various reasons, and still engage in an agreement to receive or obtain monetary incentives and remuneration. Evidence was therefore also gathered on this.

The **choices made by insurance undertakings regarding the investment vehicles** they specifically select to structure unit-linked products **have an impact on the characteristics of the unit-linked funds the insurance**

[25] Excluded from the scope of the thematic review are elements related to strategic decisions (e.g. long-term objectives and investment strategies) and operational and implementing decisions (functions of the investment operation, individual securities held, etc.).

[26] **NO** has estimated that half of the investment choices offered by the biggest insurance undertakings are funds offered by an asset manager in the same group and **NL** that 90% of AUM are managed by in-house asset managers.

undertaking has on offer to current and prospective policyholders, an element that is also considered in the thematic review.

How insurance undertakings structure unit-linked products has an impact on the characteristics of the unit-linked funds the insurance undertaking has on offer to current and prospective policyholders, an element that is also considered in the thematic review.

C. Addressing conflicts of interest and acting in the best interests of customers

The existence of the potential conflicts of interest emerging from the business interlinkages between providers of asset management services and insurance undertakings, if left unmitigated by insurance undertakings, seriously undermine the workings of the market and may thus result in consumer detriment. For this reason, **assessing how insurance undertakings manage these conflicts of interest is critical to assess the level of consumer detriment**.

In this regard, the thematic review specifically considers issues around **disclosure of these monetary practices** (transparency principle) and **rebating**, i.e., if monetary incentives and remuneration received or obtained are passed on to policyholders rather than retained within insurance undertakings. In general, full rebating might be viewed as in effect a way of achieving lower costs for the policyholder, however even where there is full rebating other potential impacts might arise – for instance, impacts on competition between different distribution channels for the fund in question, and reduced transparency in general on true costs.

Most broadly, the **thematic review considers policies that insurance undertakings have in place to ensure that they are acting in the best interests of customers** in the context of the acquisition of asset management products and services and provision of access to these to policyholders.

The principle of acting in the best interests of customers is also central to the assessment of how insurance undertakings structure unit-linked products. The thematic review considers the processes used by insurance undertakings when using in-house or external asset managers to manage assets of unit-linked funds, specifically the processes in place for selecting and monitoring asset managers and investment vehicles.

Flows of remuneration

The flows of remuneration considered for the purpose of the thematic review are **exclusively monetary incentives and remuneration received or obtained by insurance undertakings from providers of asset management services**.

Remuneration involving other entities such as monetary incentives between insurance undertakings and intermediaries is not within the scope of the thematic review. However, for purposes of completeness, the thematic review gathered evidence on whether insurance undertakings receive or obtain any monetary payments (e.g. commissions from brokers used for trade execution) or non-monetary benefits from third parties (other than asset managers) in the course of managing the insurance undertaking’s assets of unit-linked funds.

In a similar vein, **monetary incentives and remuneration of sales/frontline staff (policyholder facing) are not within the scope of the thematic review**.

It is also **not within scope of the thematic review to investigate in detail how insurance undertakings used the monetary incentives and remuneration received**, other than if these were rebated in part or wholly to policyholders, e.g. whether they are distributed to intermediaries is not within scope of the thematic review. This was in view of keeping an already complex potential review as focused as possible, given the great variety of possible business models in question.

Types of monetary incentives and remuneration

Monetary incentives and remuneration considered for the purpose of the thematic review include **any type of monetary incentives and remuneration received or obtained by insurance undertakings from asset managers**. These include any monetary incentives and remuneration effectively received from asset managers, including retrocession payments (e.g. “kickbacks” and commissions), and benefits that do not result in a direct payment from asset managers to insurance undertakings (e.g. discounts on fund management charges or on other costs and charges paid by insurance undertakings to asset managers).

Non-monetary benefits are not within the scope of the thematic review. However, for purposes of completeness, the thematic review gathered evidence on whether insurance undertakings receive or obtain non-monetary benefits from an asset manager in return for placing assets of unit-linked funds with the asset manager for management.

Products of life insurance undertakings

Products considered for the purpose of the thematic review are **unit-linked products offered by insurance undertakings through life or pension policies**. This broad scope is intended to allow for the thematic review to include the widest types of products in light of possible differences in each Member State. Accordingly, the thematic review includes products sold to retail consumers who invest in these products individually or through employers' pension schemes, as well as institutional investors who use these products as pension funding vehicles.

Regarding unit-linked products sold to retail consumers who invest in these products through employers’ pension schemes, the purpose is to include any products that are made available to employees under employers’ pension arrangements. These may be products to which voluntary employee contributions are channelled under second pillar arrangements or that fall within the scope of personal pensions but where, in both cases, the customer/policyholder is a retail client (employee). If no such arrangements exist[27], employee contributions made towards unit-linked products are still captured as these should be considered as either unit-linked products sold to institutional investors who use these products as pension funding vehicles or as unit-linked products sold to retail consumers who invest in these products individually.

The thematic review considers both unit-linked products that offer no guarantees and unit-linked products that offer some sort of guarantee at the level of the product itself (e.g. capital, return, guaranteed minimum withdrawal benefits, guaranteed minimum death benefits, guaranteed minimum income benefits, variable annuities).

While in the case of unit-linked products that offer some sort of guarantee at the level of the product, it may be argued that the return may not be linked to the actual performance of the underlying assets[28], monetary practices may still impact on the net return obtained by policyholders, depending on the terms and conditions of the contract. This is particularly the case if any capital or return guarantee is set for the fund's gross returns which would not take into account costs charged by insurance undertakings.

Furthermore, the market share of unit-linked products that offer some sort of guarantee is material in some Member States.

With-profit products and own funds are not within the scope of the thematic review, the thematic review sought evidence on whether monetary practices also apply to them in respect of underlying assets.

---

[27] These specific arrangements tend to be marginal or non-existing in some Member States.

[28] The return is either guaranteed (even if the underlying assets post negative returns) or is determined by the investment decisions taken by insurance undertakings to fulfil the guarantees under the policy.

A. Existence, magnitude and structuring of monetary practices

Key takeaways

- Monetary practices are widespread in the industry: **81% of participating insurance undertakings received monetary incentives and remuneration** from asset managers.
- **Monetary incentives and remuneration received by participating insurance undertakings during 2015 totalled EUR 3.7bn**. The estimate for the **entire market is EUR 5.2bn** in 2015.
- For those undertakings that engage in these monetary practices, monetary incentives and remuneration received represent a median value of **0.56% of assets under management and 46% of fund management charges**.
- **Monetary incentives are predominantly recurring in nature** (99% of total value received in 2015). Other types of monetary incentives and remuneration and non-monetary benefits (e.g. seminars, training or gifts) are not common.
- **Arrangements tend to be set separately for each asset manager** and cover the range of funds managed by the asset manager.
- The **level an incidence of monetary incentives and remuneration are linked to the characteristics of the underlying investment vehicle** (asset class in which the fund invests and investment strategy), not the type of investment vehicle (pooled fund or segregated portfolio) or type of asset manager (in-house or external asset manager).
- Monetary incentives and remuneration are **generally higher for investment vehicles that display higher levels of risk**, **e.g. equity and multi-asset funds and actively managed funds**.

The potential for the existence of monetary incentives and remuneration between providers of asset management services and insurance undertakings **springs from how the assets of unit-linked funds are managed**.

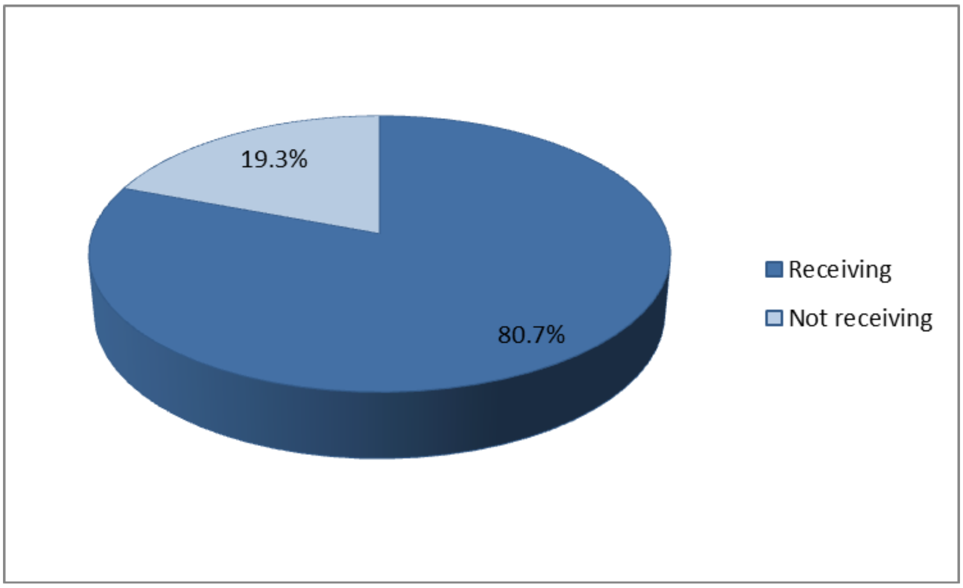
The assets of unit-linked funds are **typically managed by in-house or external asset managers** (indirectly managed assets) who are separately remunerated for their asset management services, either via fund management charges deducted from the fund assets or by explicit charges or fees paid by the insurance undertaking (and indirectly by the policyholder). The focus of this thematic review is on payments – directly or indirectly – in the opposite direction, from asset manager to insurance undertaking.

Existence of monetary incentives and remuneration

Monetary incentives and remuneration received by insurance undertakings from asset managers are widespread in the insurance industry.

The thematic review found that **81% of insurance undertakings receive or obtain some sort of monetary incentives and remuneration from asset managers** in return for placing assets of unit-linked funds with the asset managers for management.

Figure 1: Share of participants receiving or obtaining monetary incentives and remuneration



Types of monetary incentives and remuneration

Monetary incentives and remuneration received by insurance undertakings may take various forms but may, generally, be classified into two broad categories.

A. Recurring monetary incentives and remuneration

These are monetary incentives and remuneration received by insurance undertakings on a regular and ongoing basis and are normally: (i) a **percentage of the value of assets held by the insurance undertaking with an asset manager or in a specific investment vehicle**[29] (situation 1, Figure 2)[30] or/and (ii) **discounts on fund management charges** (situation 2 and 3, Figure 2).

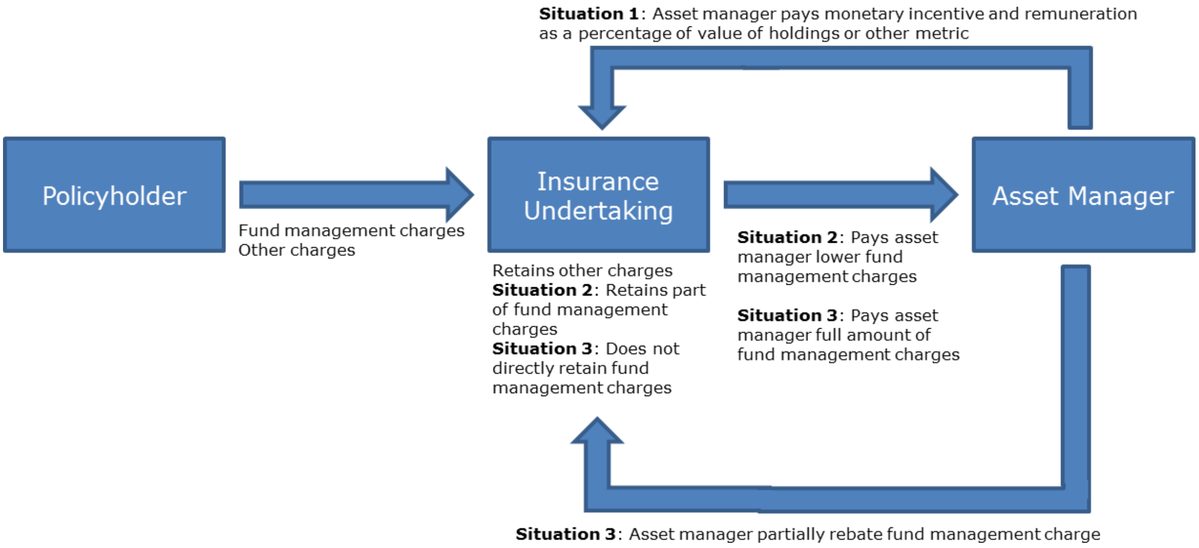
Discounts on fund management charges represent a reduction in the quoted fund management charges offered to the insurance undertaking by the asset manager. The lower charge may take the form of: (i) a built-in reduction in the

[29] I.e. size of the mandate for segregated portfolios and value of the insurance undertaking's holdings in pooled investment vehicles.

[30] There are only a limited number of participants that have indicated that they receive recurring monetary incentives and remuneration which is independent from the volume of assets held by the insurance undertaking with an asset manager.

fund management charges where the insurance undertaking is charged a lower amount than the quoted ongoing charge of the investment vehicle (situation 2, Figure 2) or (ii) a partial reimbursement where the asset manager continues to charge the quoted ongoing charge of the investment vehicle but pays back a certain amount to the insurance undertaking at regular intervals (situation 3, Figure 2).

Figure 2: Flows of charges and remuneration



Depending on the Member State and related terminology, different terms such as "rebate", "retrocession", "repayment", "trailer fee", "kick-back" or "commission" may be used to refer to the above types of monetary incentives and remuneration. For the purpose of this thematic review, "retrocessions" refers to monetary incentives and remuneration set as a percentage of the amount invested by the insurance undertaking. Discounts on fund management charges are referred to as "reimbursement" or as "built-in reduction" or, if the exact form it takes is unspecified, simply as "discounts on fund management charges".

Independently of the sub-type of recurring monetary incentives and remuneration, in essence, the value of the monetary incentives and remuneration is generally set as a percentage of the value of assets, i.e., size of the mandate for segregated portfolios or value of the insurance undertaking's holdings in pooled investment vehicles. This is the case because fund management charges are, themselves, generally set as a percentage of assets.

Considering the different terms used in each Member State and subsequent interpretations of the industry questionnaire by participating insurance undertakings, discounts on fund management charges and retrocessions have not consistently been reported separately. Moreover, as further described in this Report, some participants received both types of recurring monetary incentives and remuneration but it was not possible for all participants to allocated the exact amount received or obtained between the two types of recurring monetary incentives and remuneration.

Therefore, throughout this Report, unless stated otherwise, no distinction is made between different types of recurring monetary incentives and remuneration. For purposes of the thematic review and, as the quantitative analysis shows, this aggregation is justifiable.

B. One-off monetary incentives and remuneration

These are monetary incentives and remuneration received by insurance undertakings that **are not of a regular nature, that occur occasionally or are contingent on specific events**.

One-off payments may exist for all types of investment vehicles but tend to be **more relevant to specific investment vehicles such as structured products or property funds when the funds are being launched**. In most cases the value of one-off monetary incentives and remuneration is based on the amount invested by insurance undertakings during the launch/sales period.

Given their contingent nature, also considered as one-off monetary incentives and remuneration are any **type of reductions or exemption of entry**[31] **or exit fees**[32]. Although these may also be received or obtained on a regular basis, in particular in which concerns pooled investment vehicles, their structuring is slightly different to that of recurring monetary incentives and remuneration and are therefore included in this subcategory.

C. Other types of monetary incentives and remuneration

For purpose of completeness, the thematic review has also considered any type of monetary incentives and remuneration not included in A. and B. above. These **may include fees for funds registration, occasional rebates on performance fees if applicable**, or (along the same lines) where the insurance undertaking receives a kind of **profit sharing from the in-house asset manager**.

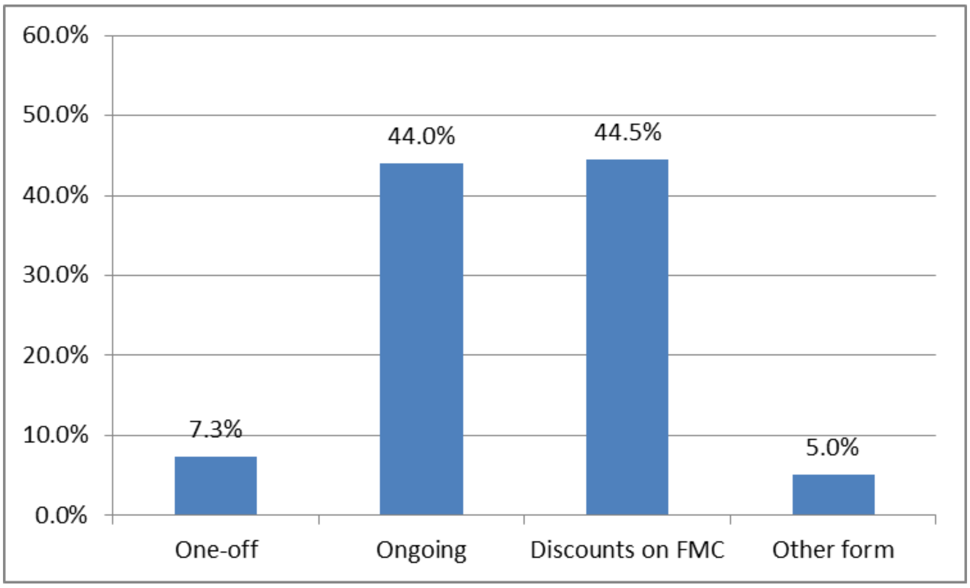
Monetary incentives and remuneration are mostly received or obtained on a regular basis. Indeed, the most common types of monetary incentives and remuneration are recurring monetary incentives and remuneration with **44% of participating insurance undertakings indicating that they receive or obtain discounts on fund management charges**. Roughly the same number of participating insurance undertakings, **44.5%, indicates that they receive or obtain some other type of ongoing monetary incentives and remuneration**.

One-off commissions/payments are less common and received or obtained by only 7% of participants. **Other types of monetary incentives and remuneration are marginal** and are received or obtained by 5% of participants.

[31] Also referred to as subscription fees or entrance fee. Fees charged when money is invested in the fund.

[32] Also referred to as redemption fees, market timing fees or short-term trading fees. Fee charged when money is withdrawn from a fund.

Figure 3: Share of participants receiving or obtaining each type of monetary incentives and remuneration



A small percentage of participants (14%) receive a combination of monetary incentives and remuneration with a negligible percentage (one observation) receiving all types of monetary incentives and remuneration indicated above.

Given the prevalence of ongoing types of monetary incentives and remuneration and of discounts on fund management charges, it should be noted that 8% of participants received both types of monetary incentives and remuneration while almost 81%[33] receive or obtain either of the two forms.

D. Non-monetary benefits

Although non-monetary benefits are not directly within the scope of the thematic review, for purposes of completeness, the thematic review sought to assess whether insurance undertakings receive or obtain them from asset managers.

Only 6% of insurance undertakings indicate that they receive non-monetary benefits from asset managers in return for placing assets of unit-linked funds with asset managers for management.

[33] Coincidently equal to the total of participants receiving some sort of monetary incentives and remuneration.

The most commonly cited types of non-monetary benefits include:

- Gifts and hospitality[34];
- Market research and analysis;
- Marketing material (e.g. fund brochures, commercial animations);
- Sales training;
- Seminars and conferences;
- Training and information sessions on products.

Non-monetary benefits, with, to some extent, the exception of gifts and hospitality, **relate, in essence, to support provided by asset managers to insurance undertakings in the sale and distribution** of the funds they manage.

Notwithstanding the need of a thorough overall analysis of all relevant circumstances, these findings seem to indicate that non-monetary benefits currently received or obtained by insurance undertakings comply with the principles of acting honestly, fairly and in accordance with the best interests of customers.

In some rare cases, asset managers may also provide ancillary services to the insurance undertaking including pricing, fund accounting, input to committees, client reporting, query services (e.g. on investment performance) and provide data to support Solvency II reporting. These services seem to be more frequently provided by in-house asset managers rather than external asset managers.

Monetary incentives and remuneration from third parties

Although monetary incentives and remuneration received from third parties (that is, other than the asset manager which in this context is the "second" party) are not directly within the scope of the thematic review, for the purpose of completeness, the thematic review sought to assess whether insurance undertakings receive or obtain incentives and remuneration from these parties.

Additional monetary incentives and remuneration received or obtained from third parties in the course of managing the insurance undertaking's assets of unit-linked funds **are not common**. Less than 5% of participants responded that they receive some sort of monetary incentives and remuneration from third parties used or selected by the insurance undertaking, while less than 3% receive some sort of monetary incentives from third parties used or selected by asset managers. Note that only in 1% of cases do insurance undertakings receive from both of these third parties.

The payments from third parties **consist mainly of custodian fees and transaction costs being rebated back to insurance undertakings** from custodians and brokers used for trade execution. In some cases where fund

[34] In compliance with internal gifts and hospitality policies.

distribution platforms are used by insurance undertakings, the **distribution platform may pay insurance undertakings on a regular basis rebates received from asset managers**. In essence the platform is an intermediary in a payment that, in fact, originates from asset managers.

Types of funds to which monetary incentives and remuneration apply

Monetary practices are not associated with specific types of unit-linked contracts. When received or obtained, monetary incentives and remuneration seem to, within the applicable regulatory framework, **apply to the underlying funds of all types of unit-linked funds**, i.e., if insurance undertakings receive or obtain monetary incentives and remuneration from a specific investment vehicle and this investment vehicle is used in structuring, for instance, both unit-linked products with and without guarantees, monetary incentives and remuneration will be received from the assets allocated to both types of unit-linked products. There are no reported situations where insurance undertakings would receive or obtain monetary incentives and remuneration for the assets of unit-linked funds without guarantees and not for the assets of unit-linked funds with guarantees, and vice-versa.

Accordingly, **differences in practices relating to different unit-linked products are, in most Member States, rather explained by the (in)existence of such products in a specific market** or by decisions by insurance undertakings on whether to offer them or not.

Although the focus of this thematic review is specifically on unit-linked funds, for purposes of completeness, the thematic review also sought to assess whether these monetary practices also apply to other types of products. Participants have indicated that monetary incentives and remuneration are also received or obtained in relation to assets of with-profit funds and own fund. This is the case whenever with-profit funds and own funds invest in investment vehicles from which monetary incentives and remuneration are received or obtained.

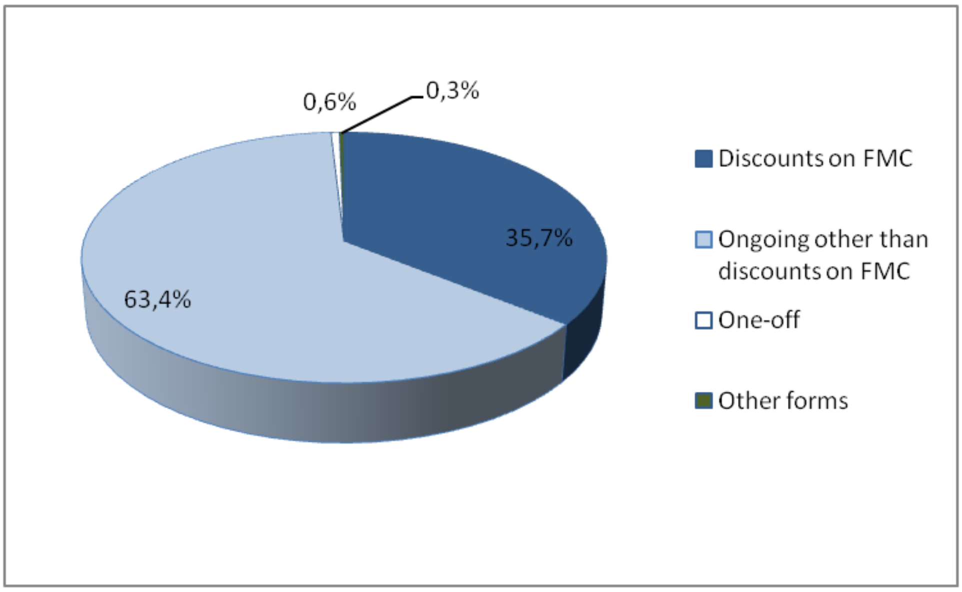
Magnitude of monetary incentives and remuneration

Monetary incentives and remuneration received or obtained by **participating insurance undertakings totalled EUR 3.7bn during 2015**. Taking into account the market share of the sample, *ceteris paribus*, the estimated total value of monetary incentives and received or obtained by the **insurance industry in 2015 is EUR 5.2bn**.

Value by type of monetary incentives and remuneration

Figure 4 below displays the distribution of the total amount received or obtained by type of monetary incentives and remuneration.

Figure 4: Distribution of amount of monetary incentives and remuneration by type of monetary incentives and remuneration – 2015



The above figure clearly shows that **recurring monetary incentives and remuneration** (discounts on fund management charges and ongoing other than discounts on fund management charges) at 99,1% **represent almost the entire amount received or obtained by insurance undertakings in 2015**, while one-off or other types of monetary incentives and remuneration are marginal.

It should, however, be pointed out that not all participating insurance undertakings differentiated between the two types of recurring monetary incentives and remuneration (discounts on fund management charges and retrocessions) or classified the monetary incentives and remuneration received or obtained according to the two definitions indicated in the industry questionnaire. For instance, some participants indicated in the qualitative input that they received discounts on fund management charges but reported the amount of monetary incentives and remuneration as ongoing monetary incentives and remuneration. As in some of these cases participants received both types of recurring monetary incentives and remuneration, it was not possible to allocated the exact amount received or obtained by the two types of recurring monetary incentives and remuneration. Therefore, any conclusions regarding differences in recurring monetary incentives and remuneration should be taken with caution.

As indicated before, throughout this Report, unless stated otherwise, no distinction is made between different types of recurring monetary incentives and remuneration. As subsequent analysis will show, this simplification has no impact on the analysis and conclusions of the thematic review.

Furthermore, it was not possible for all participants that indicated that they received or obtained other types of monetary incentives and remuneration (<2% of total participants) to quantify the monetary-equivalent amount. Qualitative input provided does, however, suggest that the amount is immaterial when compared to the most common types of monetary incentives and remuneration.

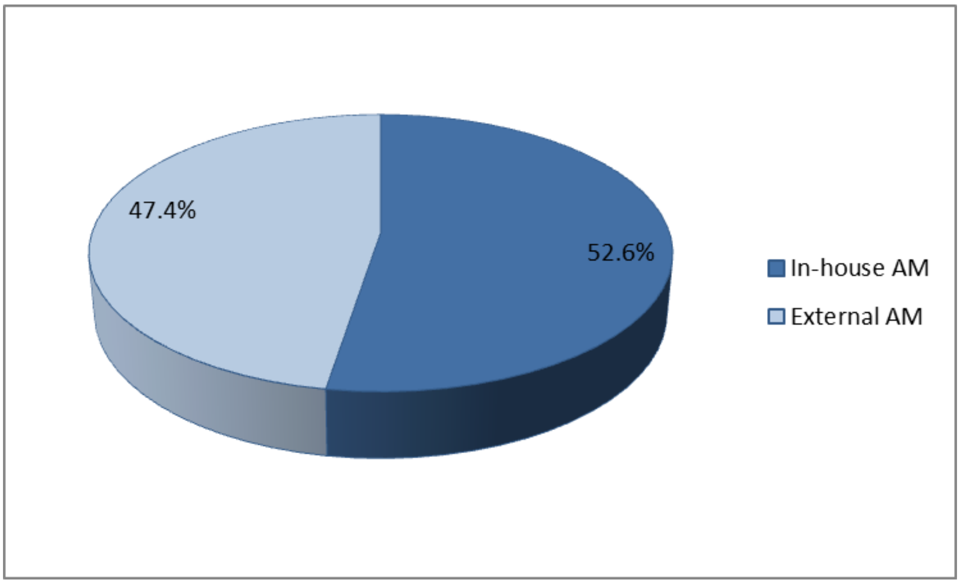
Also note that participants were not required to quantify and report non-monetary benefits or monetary payments (e.g. commissions from brokers used for trade execution) or non-monetary benefits received or obtained from third parties. As indicated before, these only apply to a small number of participating insurance undertakings (less than 6% of participants).

The above aspects do not impact in any way on the magnitude of monetary incentives and remuneration received or obtained by insurance undertakings nor on the relative importance of each type of monetary incentives and remuneration.

Value by type of asset manager

The next figure provides the split of monetary incentives and remuneration received or obtained from in-house asset managers and external asset managers.

Figure 5: Distribution of amount of monetary incentives and remuneration by type of asset manager – 2015



The amount of monetary incentives and remuneration **received or obtained from in-house asset managers is slightly higher than the amount received from external asset managers**, respectively **EUR 1.9bn** or **53%** of the total and **EUR 1.7bn** or **47%** of the total.

The 53%/47% split does not, however, find a corresponding matching when considering the split of the volume of assets by type of asset manager. Indeed, as shown in the section on the structuring of unit-linked products[35], 28.3% of the assets of unit-linked funds are managed by external asset managers which account for 47% of the total remuneration received.

In summary, **in-house asset managers pay the most monetary incentives and remuneration in absolute terms but external asset managers pay**

[35] Please refer to Figure 11: Distribution of assets by type of asset management arrangement.

more in relative terms, i.e., in relation to the volume of assets of unit-linked funds placed under the management of external asset managers. Indeed, the amount of monetary incentives and remuneration received or obtained from in-house asset managers and external asset managers represents, respectively, 0.12% and 0.26% of the total value of assets managed by each type of asset manager.

Value as a percentage of assets and fund management charges

As monetary incentives and remuneration are mostly set as a percentage of assets invested[36] or as a percentage of fund management charges (which are also normally set as a percentage of assets), unsurprisingly, the absolute value of monetary incentives and remuneration received or obtained by participating insurance undertakings shows an enormous disparity.

To assess the relative importance of monetary incentives and remuneration, for each participating insurance undertaking, the following ratios are considered: (i) ratio between total monetary incentives and remuneration received or obtained during the year and the value of assets of unit-linked funds managed by in-house or by external asset managers at year end[37] and (ii) ratio between total monetary incentives and remuneration received or obtained during the year and the value of fund management charges of in-house and external asset managers for management of assets of unit-linked funds[38].

The first ratio (as a percentage of assets under management) allows the annual amount of monetary incentives and remuneration to be measured in relation to the total investment amount. It allows for a straightforward comparison of monetary incentives and remuneration against total cost and return[39] for the same investment. For instance, a value of 1% means that for every EUR 1,000 of investment at year end, the insurance undertaking has received or obtained EUR 10 in monetary incentives and remuneration during the year.

The second ratio attempts to measure how much of the fund management charges paid during the year by the insurance undertaking are, in fact, returned or reduced. For instance, a value of 20% means that for every EUR 100 of fund management charges paid by the insurance undertaking during the year, the insurance undertaking has received or obtained EUR 20 in monetary incentives and remuneration during the year.

Considering the insurance undertakings that receive some sort of monetary incentives and remuneration, **the median value for monetary incentives and remuneration as a percentage of assets managed by in-house and**

[36] Size of the mandate for segregated portfolios or value of the holdings in pooled investment vehicles.

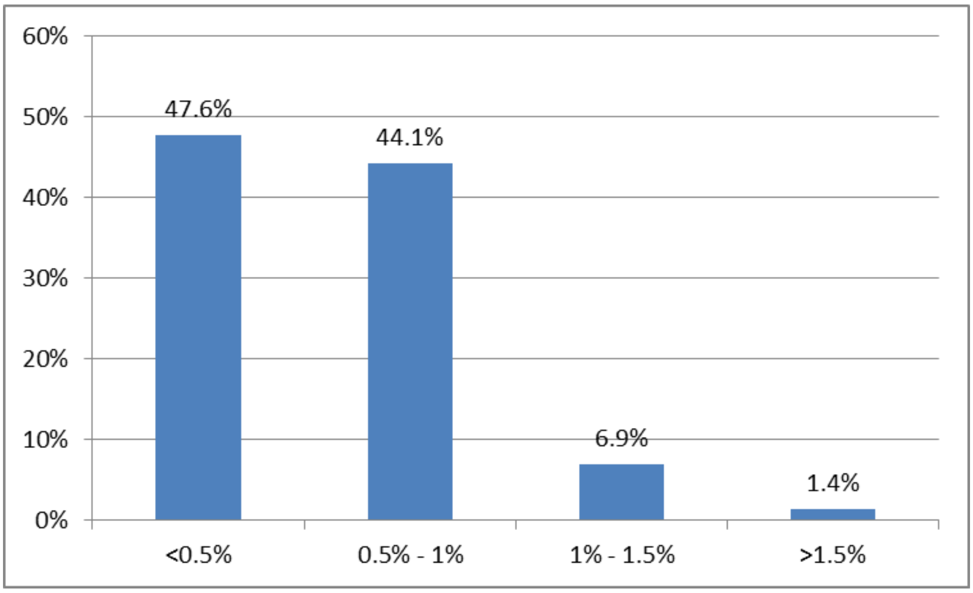
[37] "Assets of unit-linked funds managed by in-house or external asset managers" refers to the total assets of unit-linked funds managed by in-house or external asset managers not to the assets of unit-linked funds managed by in-house or external asset managers for which monetary incentives and remuneration are received.

[38] "Fund management charges of in-house and external asset managers " refers to the total fund management charges paid to in-house or external asset managers not to fund management charges paid to in-house or external asset managers from which monetary incentives and remuneration are received.

[39] For instance, the total expense ratio, or TER, which measures the total cost of a fund to an investor, is calculated by dividing the total annual cost by the fund's total assets averaged over that year, and is denoted as a percentage. Likewise, the return on the investment of an investment for a given time is given by the capital increase and generated income divided by the total investment amount.

external asset managers is 0.56%. This means that for every EUR 1,000 of investment at year end, the insurance undertaking has received or obtained EUR 5.60 in monetary incentives and remuneration. The next figure shows the distribution of participants by ranges of this ratio.

Figure 6: Frequency distribution of monetary incentives and remuneration as percentage of assets

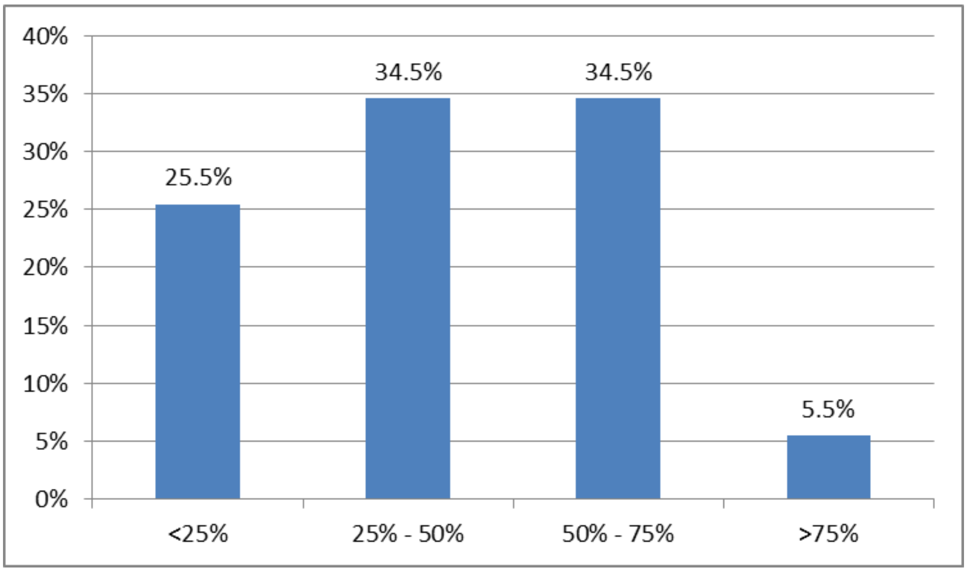


The frequency diagram above, shows that **for 92% of participants that receive or obtain some sort of monetary incentives and remuneration, total remuneration is less than 1% of assets**, while it is only above 1,5% of assets in 1% of observations. The values reported in relation to the same jurisdiction show significant differences. It is not uncommon for the highest reported value in a jurisdiction to be more than 5 times the value of the lowest observation.

In relation to fund management charges, for the insurance undertakings that receive some sort of monetary incentives and remuneration **the median value for monetary incentives and remuneration as a percentage of fund management charges is 46.1%**. This means that for every EUR 100 of fund management charges paid by the insurance undertaking during the year, the insurance undertaking has received or obtained EUR 46.10 in monetary incentives and remuneration during the same period.

The next frequency diagram, shows that **for almost 70% of participants that receive or obtain some sort of monetary incentives and remuneration, total remuneration is between 25% and 75% of fund management charges**.

Figure 7: Frequency distribution of monetary incentives and remuneration as percentage of FMC



Similarly to the first ratio used, the values reported in relation to the same jurisdiction show significant differences.

The wide range of ratios found is not surprising. Indeed, several factors come into play in determining the level of monetary incentives and remuneration received or obtained by each insurance undertaking. These impact each insurance undertaking to different extents. Country-specific factors such as market size, level of competition and implemented practices similarly impact all insurance undertakings operating in the same jurisdiction. Entity-specific factors also impact the level of monetary incentives and remuneration. These include, among others, the business model, bargaining power and the extent to which the insurance undertaking uses the different types of asset managers (in-house vs. external) and investment vehicles with different characteristics[40].

The range of values within each Member State and the relatively small number of observations per Member State limit the development of statistically meaningful cross-country comparisons. However, it may be pointed out that, overall, the lowest ratios are consistently reported in a small number of Member States.

Historical perspective

Although an historical analysis of monetary incentives and remuneration received or obtained by insurance undertakings is not the prime purpose of this thematic review, quantitative data was also collected for 2014.

As for 2015, in 2014 recurring monetary incentives and remuneration accounted for 99.1% of all types of monetary incentives and remuneration received or obtained by insurance undertakings. Also, the split between monetary incentives and remuneration received or obtained from in-

[40] E.g. pooled vs segregated investment vehicles, asset classes, investment styles (active vs. passive management), etc.

house asset managers and external asset managers was practically unchanged at 54% and 46%, respectively.

The most significant relative changes from 2014 to 2015 for the different types of monetary incentives and remuneration were for one-off (-15%) and other types of monetary incentives and remuneration (25-fold increase) but these tend to be influenced by individual variations considering their reduced frequency and absolute value. Also, as explained before, not all participants who received or obtained other types of monetary incentives and remuneration were able to quantify a monetary-equivalent amount.

Most significantly, **total monetary incentives and remuneration for the participating insurance undertakings increased by 21.7%, from EUR 3.0bn in 2014 to EUR 3.7bn in 2015**. The increase is fully explained by an equal increase in recurring monetary incentives and remuneration.

Structuring of monetary incentives and remuneration

As described in the previous section, the most prevalent types of monetary incentives and remuneration are, in essence, of a regular nature. Indeed, recurring monetary incentives and remuneration represent almost the full amount received or obtained by insurance undertakings in 2015. Even if less significant, one-off monetary incentives and remuneration, although mostly contingent on specific events, may also be of a quasi-regular nature if the events that trigger monetary incentives and remuneration take place at regular intervals, although not necessarily known in advance[41].

Form of contractual agreements

The above observation is **indicative of the existence of concords between insurance undertakings and asset managers** that set out agreed-upon terms, from which the rights and obligations of the contracting parties follow.

The thematic review did not investigate what kind of contracts asset managers and insurance undertakings enter into, specific content of contracts or in which form contracts are set (written contact, notarized contract, verbal agreement, etc.). It does, however, consider whether monetary incentives and remuneration arrangements between insurance undertakings and asset managers are set out in formal contractual agreements that bring about some kind of a legal outcome and certainty and continuity to the relationship between parties.

The **vast majority (84%) of insurance undertakings that receive some sort of monetary incentives and remuneration have formal agreements in place with all asset managers** from which monetary incentives and remuneration are received; while 15% indicate that they have such formal agreements with some (not all) asset managers. Only 1 % of insurance undertakings that receive some sort of monetary incentives and remuneration have no formal agreements in place.

[41] E.g. discounts on entry fees are contingent on money being invested in the fund.

It might be that case that, **due to practical issues, informality of business relationships or otherwise, insurance undertakings and asset managers belonging to the same group of companies may dispense with formal agreements**. We would, however, expect formal agreements to be in place if insurance undertakings are using asset managers not belonging to the same group of companies. Data does not seem to support this distinction. Indeed, some insurance undertakings that have formal agreements with only some asset managers or have no formal agreements at all, only use external asset managers. This implies that **for some external asset managers no formal agreements are in place**. Evidence also discards the possibility of informal agreements only covering types of monetary incentives and remuneration that are not regular in nature or non-monetary benefits.

The **structuring of contractual terms** for monetary incentives and remuneration between different parties **is also shaped by business models, business practices and distribution channels of investment vehicles**. In addition to contracts being set between insurance undertakings and asset managers, participants have also pointed out to others ways in which formal contractual agreement are set: (i) **with depositary/custodian banks** or (ii) with fund **distribution platforms**. In these cases, monetary incentives and remuneration are obtained directly from these parties but fund distribution platforms tend to operate as an intermediary as the payment, in fact, originates from asset managers.

The formats of contractual agreements vary depending on the nature of the relationship with the asset manager or other parties from which monetary incentives and remuneration are received or obtained. The **terms determining the conditions of monetary incentives and remuneration tend to be part of Investment Management Agreements or other formal documents setting out the terms of the range of services and the contractual agreements**. There are also cases where terms and conditions of monetary incentives and remuneration are concluded in separate and specific contracts (including Service Level Agreements and distribution agreements) between insurance undertaking and other parties (mostly asset managers).

Coverage of contractual agreements

There is a **significant diversity regarding the investment vehicles covered by a single agreement**. This reflects the different approaches taken by, on the one hand insurance undertakings and, on the other hand, asset managers. Excluding those situations where contracts are necessarily set individually for each investment vehicle[42], there are few situations where monetary incentives and remuneration arrangements are set individually for each investment vehicle. This is most often the case for segregated portfolios or when investment vehicles with each asset manager are subject to separately negotiated terms.

It should be noted that monetary incentives and remuneration arrangements are **most often set separately for each asset manager**, i.e., collectively for all pooled funds managed by the same asset manager or for all segregated portfolios managed by the same asset manager (together 31% of observations)

[42] Situations where the insurance undertaking has selected one investment vehicle managed by an asset manager.

or set individually for each pooled fund or each segregated portfolio (together 29% of observations).

Where insurance undertakings use more than one investment vehicle managed by the same asset manager, **the most common arrangement is to have arms-length agreements that cover all investment vehicles managed by the same asset manager**. These agreements do, however, allow for the remuneration of each investment vehicle to be determined individually or across a range of funds. This is particularly relevant as the level of monetary incentives and remuneration may vary according to the type of investment vehicle, asset class in which the investment vehicle invests, size of the mandate (for segregated portfolios) and flows (for pooled funds), investment style, etc.

Accordingly, it is not uncommon for insurance undertakings to have one master contractual agreement per asset manager with individual annexes for each investment vehicle where the specifics of monetary incentives and remuneration are detailed.

The thematic review **found no evidence of arrangements set collectively for different asset managers selected by the same insurance undertaking**, which suggests that insurance undertakings may not have the excessive bargaining power or a privileged dominant position to impose their own terms and conditions on asset managers. However, it has been indicated that higher levels of monetary incentives are received or obtained from smaller or newly-established asset managers wishing to see their funds distributed by insurance undertakings.

Frequency and form of payment of monetary incentives and remuneration

Formal contracts setting the arrangements between insurance undertakings and asset managers also tend to describe how monetary incentives and remuneration is calculated, how often it is paid and in what form.

There is a **significant diversity in arrangements across the industry** and is not the purpose of this thematic review to provide a description of the existing arrangements. Rather, and considering the key issues addressed, some features of these arrangements are worth mentioning. In particular, those features that may, in some way or another, be relevant when considering issues around disclosure of these monetary practices and how monetary incentives and remuneration received may be passed on to policyholders.

Some participants have indicated that the value of remuneration is calculated on a daily basis considering the net asset value of the invested assets. This possibility implies that **it is feasible, from a practical perspective, to calculate and allocate to each policyholder, on a daily basis, the corresponding value of monetary incentives and remuneration**[43]. This is particularly relevant when insurance undertakings pass on to policyholders monetary incentives and remuneration received.

The **most common frequency of payments from asset managers to insurance undertakings is quarterly**, with 84% of participants indicating that

[43] Also considering different invested amounts and entry and exit dates.

this is the frequency for some of their arrangements[44]. Less recurrent payment rates (e.g. annually) are not common but the same applies to more frequent ones. At most, monetary incentives and remuneration are paid on a monthly basis. **Monetary incentives and remuneration are normally received in arrears** some time (most commonly cited deferment is 30 days) after the end of the reference period. **In the vast majority of cases the payment is made by bank transfer**.

Processes and resources seem to be relevant to how insurance undertakings receive or obtain monetary incentives and remuneration. In fact, these processes, in particular when insurance undertakings use a vast array of funds and asset managers, may be rather burdensome and significantly resource consuming. This has lead **third parties to provide outsourced services relating to these monetary practices**. These services include the negotiation of agreements, contractual and administrative management and the calculation and collection of monetary incentives and remuneration on the behalf of insurance undertakings.

Drivers of the level and incidence of monetary incentives and remuneration

In identifying how monetary incentives and remuneration are set, it is relevant to understand how, if at all, monetary practices vary and if there are any potential drivers that may help explain any variations. The thematic review considers how, if at all, monetary practices vary by: (i) type of investment vehicle (pooled funds vs. segregated portfolios) and (ii) type of asset manager (in-house vs. external asset managers).

To assess the impact of these two potential drivers, participating insurance undertakings were requested to indicate whether monetary incentives and remuneration received vary according to: (i) the type of investment vehicle and, if so, (ii) for which type of investment vehicle are these generally more common and (iii) for which type of investment vehicle are these generally higher. The same approach was used to assess variations depending on the type of asset manager.

This method was preferred over an in-depth analysis which would require highly granular data and considerable resources to collect and process data. Also, as these drivers may jointly influence[45] the level of monetary incentives remuneration, there was no prior certainty that meaningful results and clear conclusions could be extracted from the gathered data.

Results should be interpreted with caution as they are based on the individual responses from participants. Individual responses are shaped by existing market knowledge, insights and own circumstances. Own circumstances probably play a critical role in the assessment made by participants. Reported differences are not to be understood as universal across the entire insurance industry or as applying similarly in all Member States. Both individual insurance undertakings as well as Member States display considerable diversity of arrangements and practices.

[44] The 84% consider responses where quarterly was indicated as the sole frequency and responses where it was cited together with another frequency (e.g. monthly or quarterly, quarterly or annually, etc.).
[45] Either working together or against each other.

Type of investment vehicle

Almost two-thirds (64%) of participating insurance undertakings indicate that monetary incentives and remuneration do not vary by type of investment vehicle (pooled fund or segregated account in which undertakings directly invest). However, as further detailed in this Report, not all insurance undertakings participating in the thematic review use both types of investment vehicles and may, therefore, not have complete knowledge of market practices.

Considering those insurance undertakings that use both pooled funds and segregated portfolios and which, therefore, have experience with both types of investment vehicles, the opposite results were found. almost two-thirds (63%) of participants that use both types of investment vehicles have indicated that **monetary incentives and remuneration received vary by type of investment vehicle** and that monetary incentives and remuneration **are more common for pooled funds** (75% of responses) **as well as higher** (85%) when compared to segregated accounts.

Evidence gathered from the sample of more than 1800 underlying investment vehicles used by insurance undertakings in the structuring of unit-linked funds, supports the qualitative input of participants. Indeed, the results indicate that the **average annual remuneration received as a percentage of the holdings is significantly higher for pooled funds (0.49%) than segregated portfolios (0.17%)**.

Type of asset manager

The **type of asset manager does not seem to be a differentiating element for monetary incentives and remuneration**. Both the entire universe of participating insurance undertakings and the sub-set of undertakings that use both types of asset managers, indicate that monetary practices do not vary by type of asset manager with, respectively 67% and 56% of responses.

Those insurance undertakings reporting differences indicate that monetary incentives and remuneration tend to be higher from in-house asset managers (58% of responses) but more common from external asset managers.

The results should be interpreted with caution as the number of participants that use both types of asset managers and who have indicated differences is relatively small. Also, less than 20% of participants were, in fact, able to indicate for which type of asset manager monetary practices are more common. Other participants indicated they did not have enough market information to make any conclusions.

These results, based on the individual responses, should also not be perceived as contrary to the finding reported regarding magnitudes, where it is reported that in-house asset managers pay the most monetary incentives and remuneration in absolute terms but external asset managers pay more in relative terms.

Evidence gathered from the sample of more than 1800 underlying investment vehicles used by insurance undertakings in the structuring of unit-linked funds, supports the qualitative input of participants. Indeed, the results indicate that **the average annual remuneration received as a percentage of the holdings is similar for in-house asset managers (0.46%) and for external asset managers (0.39%)**.

Characteristics of the investment vehicle

If not the frequency itself, the level of monetary incentives and remuneration is strongly correlated to the level of fund management charges. As described before, for the most important types of monetary incentives and remuneration (recurring), the value of monetary incentives and remuneration is set as a percentage of the value of assets[46]. This is either directly the case when monetary incentives are negotiated as a percentage of the value of assets held by the insurance undertaking with an asset manager or indirectly when monetary incentives are negotiated as discounts on fund management charges which are, in the vast majority of cases, set themselves as a percentage of assets.

Accordingly, if the investment vehicle displays certain characteristics that imply higher fund management charges, the level of monetary incentives and remuneration will also be higher.

Evidence corroborates this premise as 63% of participants indicate that the level of monetary incentives and remuneration received or obtained varies by type of investment mandate. Specifically, participants have indicated that the level of monetary incentives and remuneration varies according to: (i) the asset class in which the fund invests and (ii) the investment strategy (active vs. passive investment).

Regarding differences per asset class in which the investment vehicle invests, qualitative input provided by participants indicates that, in general, fund management charges on more risky assets tend to be higher than on less risky assets. Moreover, **participants have indicated that, since monetary incentives and remuneration are positively correlated with the level of fund management charges, the level of remuneration obtained from more risky funds is also higher**. Overall, the qualitative input provided indicates that monetary incentives and remuneration tend to be higher for absolute return funds and equity funds than for fixed income funds or money market funds[47].

Evidence gathered from the sample of more than 1800 underlying investment vehicles used by insurance undertakings in the structuring of unit-linked funds, supports the qualitative input of participants. Indeed, the results indicate that **the average annual remuneration received as a percentage of the holdings is higher for equity funds (0.54%) than for bond funds (0.24%) and money market funds (0.25%)**.

Overall, participants have also indicated that actively managed strategies normally entail higher monetary incentives and remuneration in comparison to passive strategies. For instance, some participants have reported that they receive or obtain monetary incentives and remuneration from actively managed funds but that Exchange Traded Funds[48] do not pay any monetary incentives and remuneration.

---

[46] Size of the mandate for segregated portfolios or value of the insurance undertaking's holdings in pooled investment vehicles.

[47] Most significantly now in a negative yield environment.

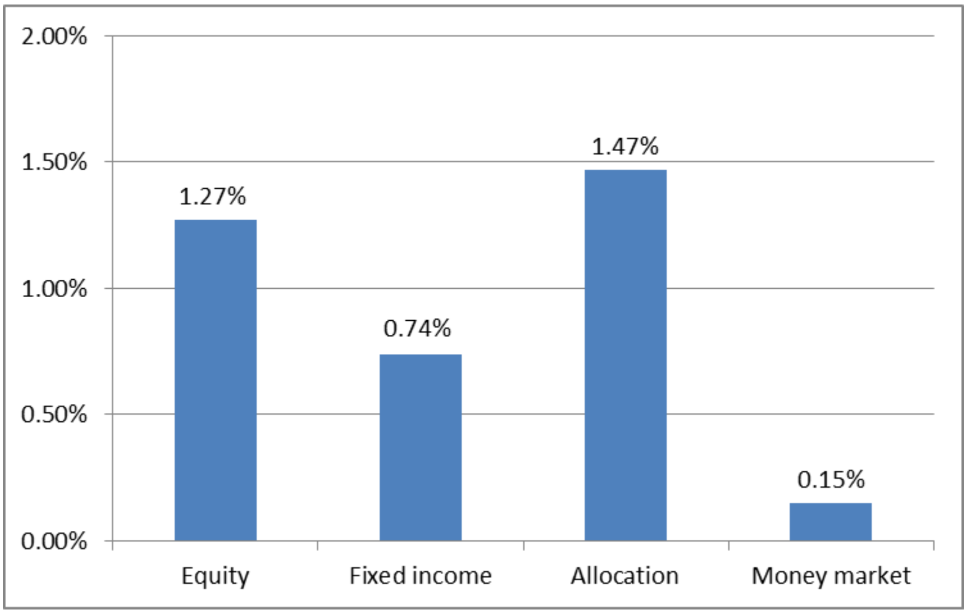
[48] Exchange Traded Funds (ETFs) are funds that track one market index but that can be traded like a stock.

Evidence gathered from the sample of more than 1800 underlying investment vehicles used by insurance undertakings in the structuring of unit-linked funds, supports the qualitative input of participants . The **average annual remuneration received as a percentage of the holdings for active funds is 0.44% against 0.32% for passive funds**.

Considering how monetary incentives and remuneration are generally set, the absolute level of remuneration is positively correlated with the value of assets held by the insurance undertaking with an asset manager or in a specific investment vehicle[49]. Regarding the relative value, only a few participants have indicated the existence of volume triggers (i.e. monetary incentives and remuneration are only being received once the volume of assets reaches a pre-set threshold) or escalating arrangements (i.e. monetary incentives and remuneration are proportionally higher for higher levels of assets).

Market research also lends support to the reported evidence that higher fees are paid for more risky asset classes and for actively managed funds. For instance, a recent study of European investment funds by Morningstar[50] found that the ongoing charges[51] for allocation funds[52] and equity funds were generally higher than for fixed income funds or money market funds as the next figure shows.

Figure 8: Asset-weighted ongoing charges per asset class - 2016



Source: Morningstar, European Fund Expenses Are Decreasing in Percentage, August 2016

[49] Size of the mandate for segregated portfolios and value of the insurance undertaking's holdings in pooled investment vehicles.

[50] European Fund Expenses Are Decreasing in Percentage. Available at http://media.morningstar.com/uk%5CMEDIA%5CResearch_Paper%5C2016_Morningstar_European_Cost_Study_17082016.pdf.

[51] As defined under the Key Invest Information Document Regulation (Commission Regulation (EU) 583/2010) available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:176:0001:0015:en:PDF.

[52] Funds classified as allocation funds in this study pursue similar investment objectives to funds classified as multi-asset funds for purpose of the present thematic review.

In the same way, the study also found that the overall asset-weighted ongoing charge paid by passive equity fund investors across Europe is 0.31%, compared with 1.38% for active funds.

Sources of potential consumer detriment

The existence of the monetary practices is indicative of the possible presence of significant conflicts of interest which could seriously undermine the workings of the market if left unmitigated, and thus result in consumer detriment.

The Report will further assess their impact on how insurance undertakings select asset managers and underlying investment vehicles and thus structure unit-linked funds. These choices will, ultimately, impact policyholders, notably where there is not full rebating in place. Irrespectively of their impact on how assets of unit-linked funds are managed, their simple existence entails risks to consumer protection and the functioning of markets.

Monetary incentives and remuneration retained by insurance undertakings may indirectly lead to higher costs to policyholders. These monetary practices may be understood as an additional cost borne by policyholders – where not fully rebated – or an appropriation of an economic benefit. In this sense, it could be argued that, *ceteris paribus*, consumer detriment could cease to exist if no such practices occurred or if the value of the economic benefit could be fully captured by policyholders – that is, where fully rebated.

This **rationale would only hold true if the value of monetary incentives that insurance undertakings would no longer receive from asset managers is not counterweighed in part or in full by an increase in fees charged to policyholders**.

Indeed, **it is also often argued that monetary incentives and remuneration** paid by asset managers **enable insurance undertakings to keep charges to consumers at a lower rate** and that, **without monetary incentives and remuneration, fees charged to policyholders would be higher**, leaving consumers no better off. The thematic review did not collect data to specifically address this issue and did not seek to establish comparisons of costs charged to policyholders in situations where monetary practices exist versus those situations where they do not exist. To do so in a definitive manner, would require a more extensive and different kind of analysis, modelling value chains, cost and pricing models and decision processes for different insurance undertakings across different markets.

However, the evidence gathered in **NL** by the Authority for the Financial Markets (AFM) on the impact of the ban introduced in 2014 on commissions for investment services may put this argument into question. According to the AFM, in terms of products, the introduction of the inducement ban increased the level of competition between manufacturers with positive impacts for consumers on two fronts. Firstly, some manufacturers reduced prices, especially for passive funds[53], in some cases by as much as 50%. Secondly, distributors became more sensitive to product quality. Whereas previously distributors would tend to

[53] Passive funds are funds that aim to replicate a particular market index or benchmark.

negotiate the most favourable distribution inducement, they now attempt to maximize their revenues in other ways by focusing on the services that best serve customer needs, increasing efficiency and selecting high-quality investment funds.

As far as services are concerned, a striking feature of the inducement ban was an increasing differentiation among services available to consumers depending on their particular needs[54]. This, in turn, resulted in a significant increase in price differentiation depending on the level of services provided. For instance, there has been a significant reduction (on average from 75bps to 25bps) for execution-only customers.

The **evidence of the thematic review also puts into question some of the arguments put forward to explain the rationale for the existence of monetary practices** and the arguments that without monetary incentives and remuneration, fees charged to policyholders would be higher.

Firstly it is **argued that monetary incentives and remuneration are generally provided on the grounds that they are intended to cover for costs incurred by insurance undertakings**. These include marketing and distribution costs of the asset managers' funds, as well as administrative costs such as handling of the investment vehicles and customer support.

If monetary incentives and remuneration are, indeed, intended to cover for the costs of marketing and distribution incurred by insurance undertakings, one would probably expect a reasonable correlation between the level of monetary incentives and remuneration received or obtained and the services provided by insurance undertakings. This does not, however, seem to be the case. Firstly, monetary incentives and remuneration have been reported for insurance undertakings' own funds, which have no distribution or marketing costs. Secondly, variations in the remuneration received by insurance undertakings from different types of investment vehicles and different types of asset managers have been reported. This would imply that marketing and distribution costs vary significantly by investment vehicle. Although one may assume that marketing and distribution costs vary across insurance undertakings, variations in marketing and distribution costs across funds within the same insurance undertaking are less consistent with marketing and distribution costs being essentially of a fixed or quasi-fixed nature. This is inconsistent with observed selling practices and distribution models.

Another argument explaining the existence of monetary incentives and remuneration is that **life insurance undertakings are customers with large volumes**. **The evidence collected is not necessarily supportive of this argument**. The thematic review found no evidence that the size of the insurance undertaking's unit-linked business is a driver or distinguishing factor for the monetary practices. Indeed, there does not seem to be a direct link between the size of insurance undertaking's unit-linked business and both the existence or level (in absolute terms and relatively to the volume of assets) of monetary incentives and remuneration. This is true across the entire market, as well as for each national market. Moreover, the thematic review found evidence that the smallest participating insurance undertakings in each market also receive or obtain some sort of monetary incentives and remuneration.

[54] Previously customers had a choice between execution only and complete bespoke services.

The **magnitude of these practices is also significant from a consumer perspective**. Monetary incentives and remuneration received represent a median value of **0.56% of assets under management** for those undertakings that engage in these monetary practices[55] (or about 0.2% of the total assets of unit-linked funds). If the value of monetary incentives and remuneration could be fully captured by policyholders in higher net returns, it would be equivalent to this value. An increase of 0.56% in annual net return may have a non-negligible impact for policyholders in a low-yield environment and, in particular if you consider that some may have long investment horizons, e.g. saving for retirement.

There are also some sources of potential consumer detriment emerging from how the contractual agreements establishing these practices are set. The **inexistence of formal contracts detailing these practices when practices do in fact exist is highly questionable from a governance and risk management perspective**. This raises questions on how, in general, the business relationships between insurance undertakings and asset managers are formally established and **if the terms set are sufficiently protective of the interests of the insurance undertaking and, ultimately, the policyholder**.

Another aspect of the contractual agreements that may lead to consumer detriment is in **cases where insurance undertakings are bound by agreements to select funds from one asset manager only** (e.g. exclusivity agreements or group-level agreements). This practice may raise **questions as to how effectively insurance undertakings are able to ensure they are always acting in the best interests of customers, i.e. selecting the most relevant or competitive funds**, providing appropriate choice or targeting of offering to policyholders.

The procedure regarding the frequency and form of payment of monetary incentives and remuneration may raise **questions regarding the ability of insurance undertakings to effectively and correctly pass on to policyholders any remuneration received** (rebate). This is particularly relevant if insurance undertakings want to ensure that policyholders who redeem a unit-linked fund promptly receive any monetary incentives and remuneration they are entitled to. Some procedures are more efficient in ensuring this objective, such as monetary incentives and remuneration being received as additional units of the underlying investment vehicle rather than as cash transfers.

[55] Considering the value of the monetary practices in 2015.

B. Structuring of unit-linked products

Key takeaways

- Less than **3% of unit-linked assets are directly managed by insurance undertakings**.
- **In-house asset managers** (belonging to the same group as the insurance undertaking) manage **69% of unit-linked assets**.
- **External asset** managers manage **28% of unit-linked assets but pay almost 50% of total remuneration**.
- Investment structures and **asset management arrangements are relatively simple** with insurance undertakings using a limited number of asset managers and investment vehicles.
- In many instances, **insurance undertakings operate, in respect of the units offered in unit-linked contracts, as *de facto* distributors** of pooled funds, with no significant divergence (at the level of the units) between units offered and funds used to underlie them;
- Insurance undertakings **invest a significant proportion of unit-linked assets in funds that pay higher levels of monetary incentives and remuneration** (e.g. almost 60% of assets are invested in funds that pursue an active investment strategy; 63% of funds are equity or multi-asset funds).
- Unit-linked funds offered to customers mirror the choices made by insurance undertakings in terms of the underlying investments: most unit-linked products are equity or multi-asset funds and most funds pursue an active investment strategy.

Asset management arrangements

Insurance undertakings tend to execute all activities related to marketing, client relationship management and to the administration of the insurance contract itself but in the case of the management of the pool of assets of unit-linked funds, the situation is rather more varied.

Insurance undertakings may manage assets directly, thereby taking investment decisions regarding which specific securities (e.g. bonds, equities) to hold, to buy or to sell, with the assets in question directly held in portfolios[56], with the payout on units offered to policyholders reflecting the performance of these portfolios. Alternatively, **insurance undertakings may use external investment vehicles in the structuring of unit-linked products**, in which case, an asset manager, not insurance undertakings, would take the investment decisions

[56] Hereafter, directly managed assets.

regarding which securities to hold, to buy or sell in respect of each external investment vehicle selected[57].

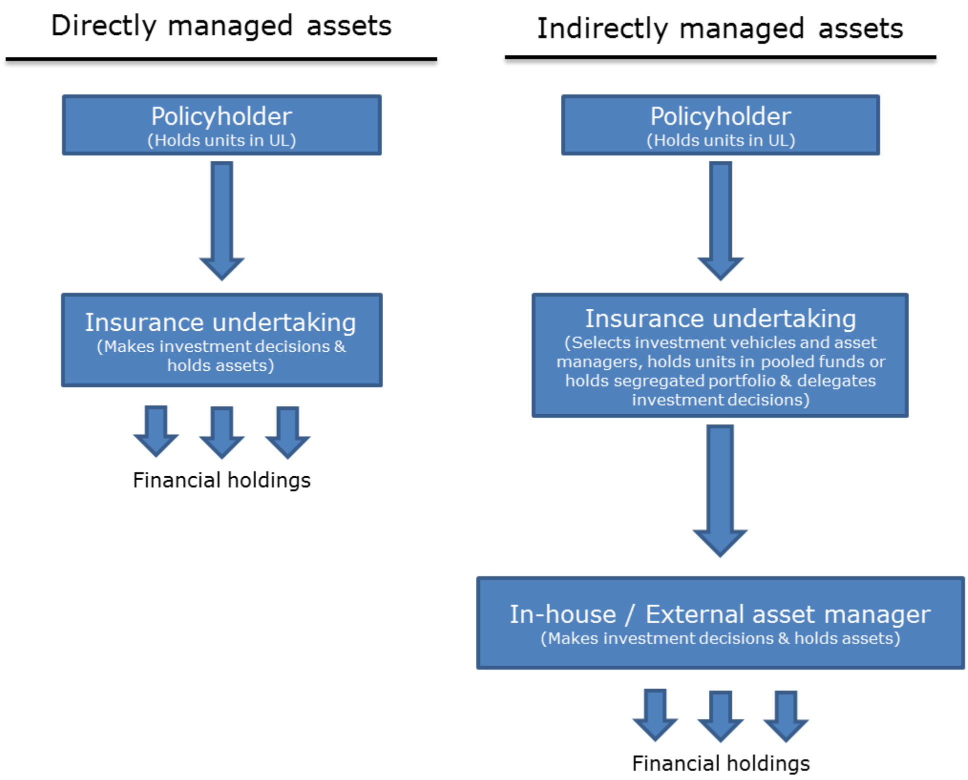
These **external investment vehicles may be either operated by an asset manager within the same financial group**, i.e., an asset management company owned or controlled by the insurance undertaking or vice-versa or an asset management company that is owned or controlled by the same holding company that owns or controls the insurance undertaking[58] **or by an entity outside the financial group**[59].

Regarding the investment vehicles managed by in-house or external asset managers, insurance undertakings **may use existing collective investment schemes** offered by the asset manager[60] **or use segregate portfolios** where external asset managers provide (bespoke) portfolio management services to the insurance undertakings[61].

There can also be other arrangements in some markets that are far less common overall (for instance, where an external asset manager provides a portfolio management service under the control of the policyholder, rather than the insurance undertaking).

The next figure depicts the arrangements described above.

Figure 9: Asset management arrangements – directly and indirectly managed assets



57 Hereafter, indirectly managed assets.
58 Hereafter, in-house asset manager.
59 Hereafter, external asset manager.
60 Hereafter pooled fund(s).
61 Hereafter segregated portfolio.

Insurance undertakings pursue different business models depending on various endogenous and exogenous factors (e.g. applicable regulation, competitive environment, etc.) and the prevalence of different approaches to asset management activities may, therefore, differ significantly by market.

Insurance undertakings **may use various combinations of arrangements**. For instance, they may directly manage part of the unit-linked assets and use, in combination, one or more in-house and/or external asset managers. For the management of indirectly managed assets insurance undertakings may also use a combination of various pooled funds and/or segregated portfolios which can also be managed by different asset managers.

At its simplest, insurance undertakings **may offer external fund links**. These funds invest in a single reinsured fund[62] or a collective investment scheme[63] managed by an asset management subsidiary or an external asset manager. It is not uncommon for external fund links to be "repackaged" or "labelled" as funds of the insurance undertaking. When a policyholder opts to invest in external funds, the insurance undertaking buys units in external funds on the policyholders' behalf but the units are not directly owned by policyholders. Also, the investment performance of the insurance undertaking's version of external funds may be different to that of the underlying funds due to differences in charges, cash management and taxation.

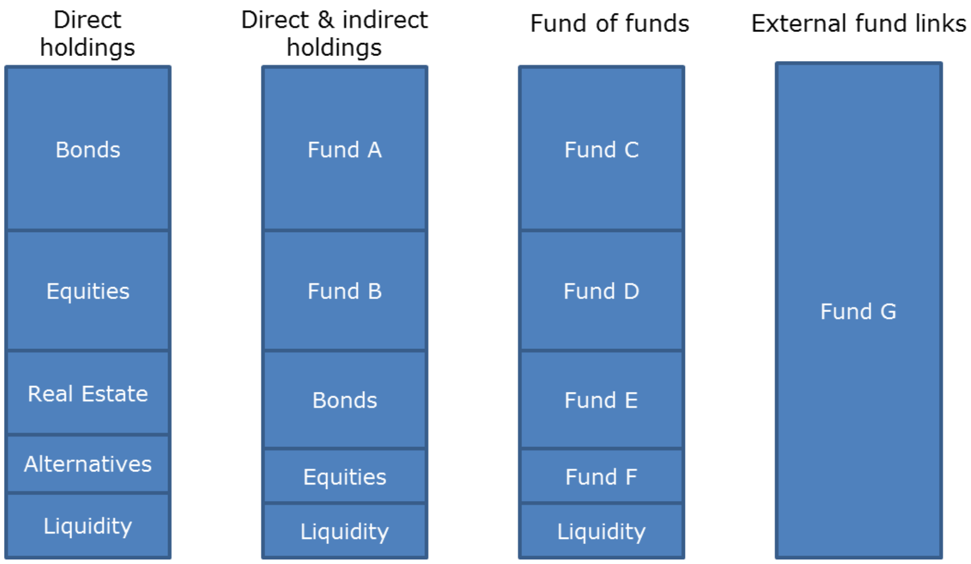
Insurance undertakings may also combine one or a small number of investment vehicles with direct holdings in structuring the portfolio of a unit-linked fund. Insurance undertakings may also offer fund-of-funds, where a unit-linked fund is a combination of different external funds (e.g. UCITS) without any direct holdings (except liquidity). The fund-of-funds could in turn be managed by the insurance undertaking directly, by an in-house asset manager or by an external asset manager.

The next figure depicts the various situations described above.

[62] A unit-linked fund managed by another insurance undertaking.

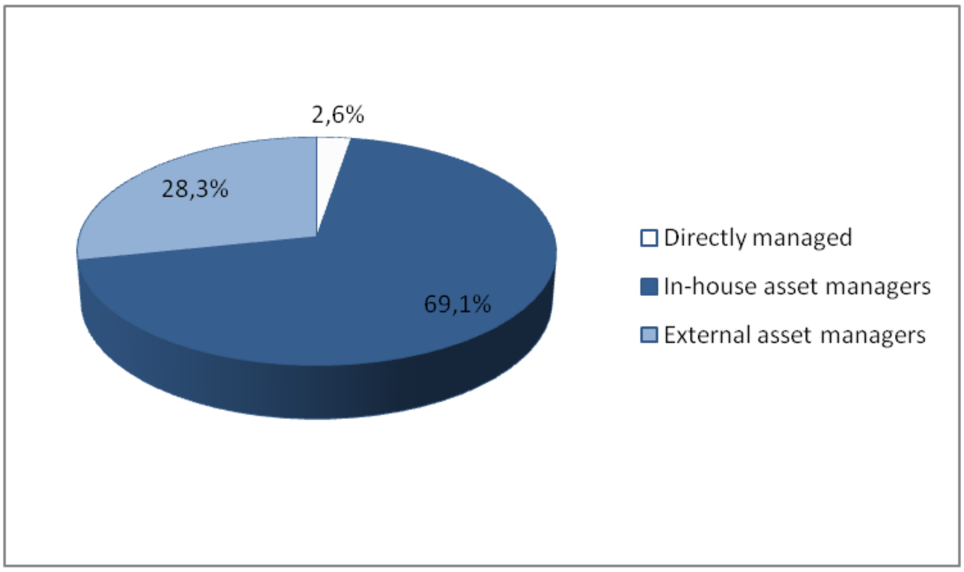
[63] E.g.: Unit trust, investment trust and open-ended investment companies (OEICs).

Figure 10: Asset management arrangements – composition of funds



As detailed above, the assets of unit-linked funds may be directly managed by the insurance undertaking, or the insurance undertaking may delegate the investment function to either in-house or external asset managers. The next figure displays the distribution of the assets allocated to unit-linked funds by the three types of arrangements.

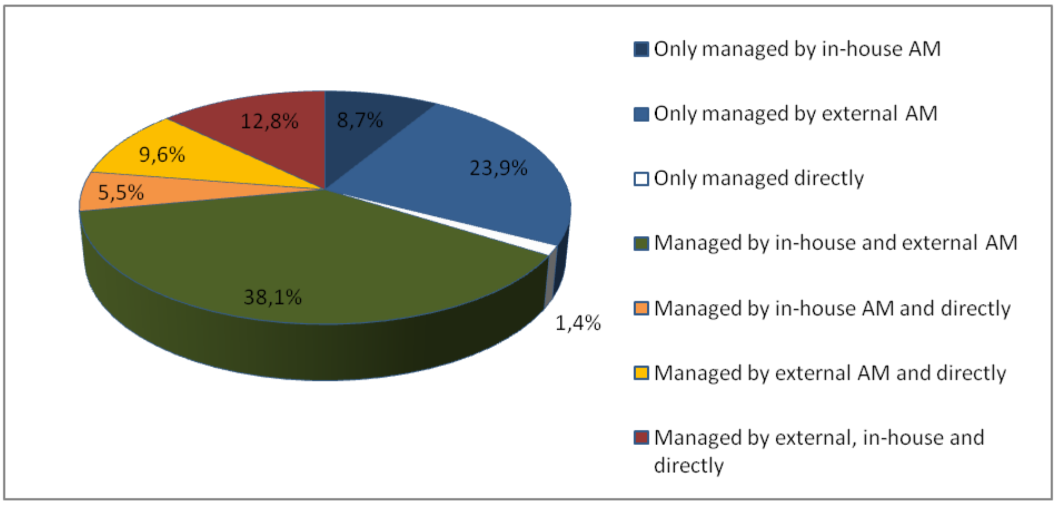
Figure 11: Distribution of assets by type of asset management arrangement



The share of assets of unit-linked funds directly managed by insurance undertakings is small, while asset managed by in-house asset managers represent a significant share of total assets allocated to unit-linked funds. Considering the market share of participants, it is **estimated that for the entire unit-linked market, circa EUR 1.85tr of assets of unit-linked funds are managed by in-house asset managers** while **assets of unit-linked funds managed by external asset managers amount to EUR 750bn**.

Looking at the asset management arrangements that insurance undertakings use, i.e., the combinations of assets directly managed, assets managed by in-house asset managers and assets managed by external asset managers, the thematic review found that **all possible combinations are, indeed, used**. The next figure shows the relative share (measured by number of participants) of each arrangement used.

Figure 12: Distribution of asset management arrangements by number of participants



The above results are not surprising considering that assets directly managed by insurance undertakings represent only 2.6% of total assets of unit-linked funds. However, the results are revealing of the **large share of asset management arrangements where insurance undertakings play no direct role in the management of assets**. Indeed, in 70% of the arrangements considered, assets are managed only by in-house asset managers, only by external asset managers or a combination of both.

The relatively high number of participating insurance undertakings that do not directly manage assets is not directly linked to the size of the insurance undertakings as, within the same jurisdiction, the thematic review found large, mid-sized and small insurance undertakings directly managing assets. **Asset management arrangements seem to be explained by business or distribution models or country-specific market structures, rather than by the size of insurance undertakings**. Indeed, in 7 Member States no participating insurance undertakings directly managed assets. Market size may not be a driver as these 7 Member States comprise large and small unit-linked markets.

Asset managers

Participating insurance undertakings **reported using a total of 268 in-house asset managers and circa 7,000 external asset managers**[64].

The vast majority of participating insurance undertakings **use a limited number of asset managers**. Indeed, the median[65] number of asset managers used is 9: **1 in-house asset manager and 8 external asset managers**.

To provide a little more detail: of the 66% (144 out of 218) of participating insurance undertakings that use in-house asset managers, only 6% (9 out of 144) use 5 or more in-house asset managers, while 60% use a single asset manager.

Regarding the number of external asset managers used, of the 83% (180 out of 218) insurance undertakings that use external asset managers, 32% use 5 or less asset managers while less than 10% use 100 or more asset managers.

Concentration by asset managers used

The above analysis is indicative that insurance undertakings tend to rely on a limited number of asset managers, in particular if they use in-house asset managers, while, on the other hand, some outliers use a large number of asset managers in the context of external managers. Indeed, as can be seen from the next figure, **the largest single asset manager used by each insurance undertaking is responsible for, on average[66], managing almost 60% of the insurance undertaking's unit-linked assets**. This ratio rises to 76% and 80% if the 3 largest and the 5 largest asset managers used are considered, respectively[67]. More striking is the fact that, taken together, the single largest asset managers used by each of the 218 participating insurance undertakings manage 79% of the total assets of unit-linked funds.

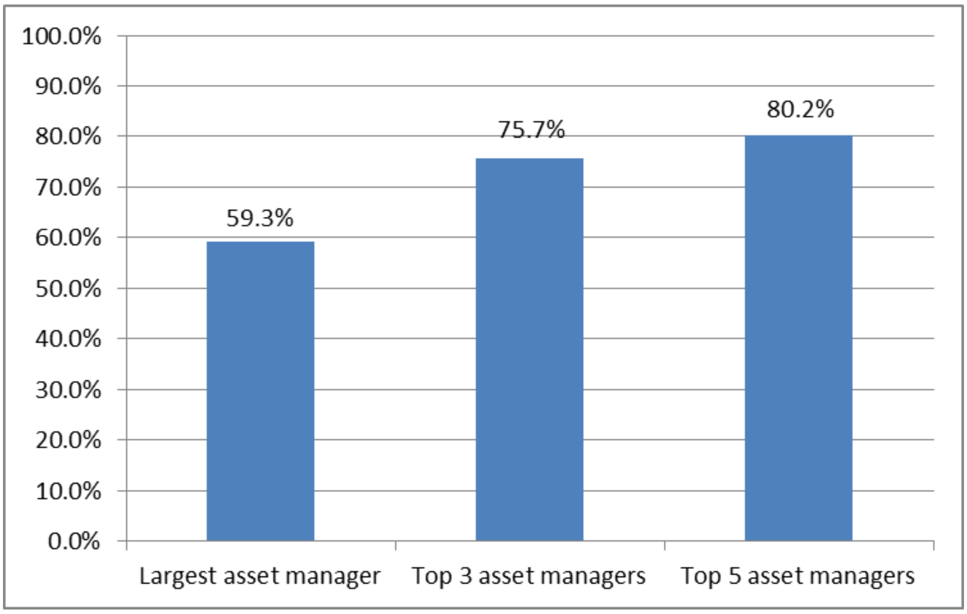
[64] It is not possible to determine exactly how many asset managers are used as a whole due to the possibility of double-counting. The same asset manager may manage assets for more than one insurance undertaking and is therefore reported more than once in individual responses.

[65] The median was preferred over other statistical measures of central tendency (e.g. mean) as it is not affected by outliers.

[66] Unweighted average of the individual responses.

[67] These percentages are 64%, 83% and 88% if assets directly managed by insurance undertakings are excluded.

Figure 13: Average share of assets managed by largest asset managers used by each participant

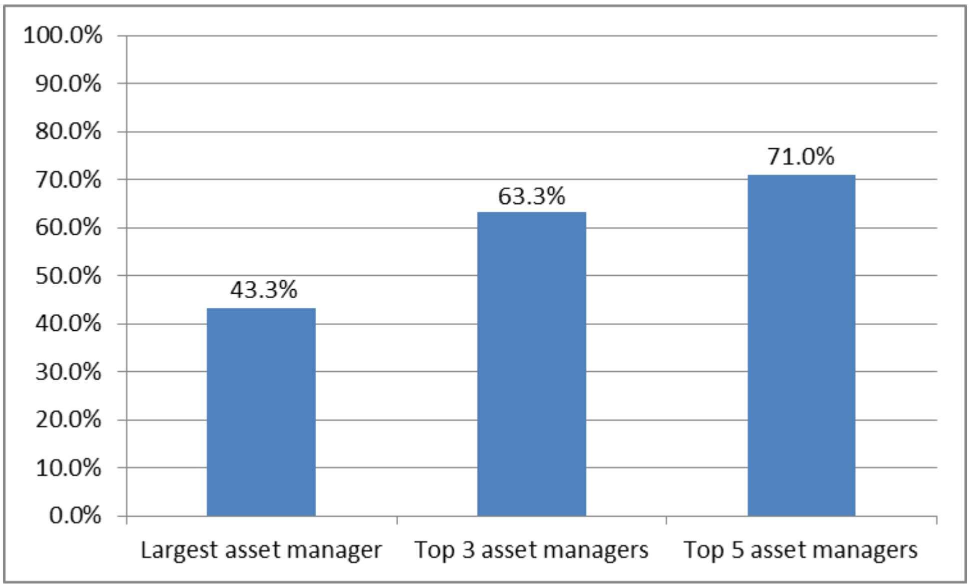


These figures are impacted by the fact that the **larger insurance undertakings have, comparatively, a higher proportion of assets managed by their single largest asset manager**. Overall, EUR 1tr (or 53% of total sample) of unit-linked assets is managed by the 10 largest asset managers.

In terms of the number of investment vehicles managed by the largest asset managers used by insurance undertakings, the concentration ratios are not as high as those for the overall volume of assets managed, but still significant. **The largest single asset manager used by each insurance undertaking is responsible for, on average, managing 43% of the investment vehicles used**. This ratio rises to 63% and 71% if the three largest and the 5 largest asset managers are considered, respectively[68], as shown in the next figure.

[68] These percentages are 46%, 67% and 76% if assets directly managed by insurance undertakings are excluded.

Figure 14: Average share of investment vehicles managed by largest asset managers used by each participant



In contrast to the situation for the volume of assets managed, the investment vehicles managed by the largest asset manager used by each insurance undertaking represent 18% of the total number of investment vehicles used. However, if the three largest asset managers used by each insurance undertaking are considered, these are responsible for managing almost half of all investment vehicles used by insurance undertakings.

Overall, evidence shows that the number of asset managers used is somewhat correlated with the size of the insurance undertaking's unit-linked business[69] and, not surprisingly, the undertakings that use a significant number of asset managers tend to be from the largest markets as well. For instance, the insurance undertakings using 100 or more asset managers are domiciled in 8 jurisdictions.

Investment vehicles

Unsurprisingly, considering the relative share of in-house and external asset managers used, participating insurance undertakings **reported using a total of almost 10,400 investment vehicles managed by in-house asset managers and circa 59,300 managed by external asset managers**[70]. The difference, in relative terms is, however, significantly lower than the difference between the number of in-house asset managers against external asset managers[71].

The median number of investment vehicles managed by in-house asset managers is 22, while for investment vehicles managed by external asset

[69] Considering the level of assets under management.

[70] It is not possible to determine exactly how many investment vehicles are used as a whole due to the possibility of double-counting. The same pooled fund may be used by more than one insurance undertaking and is therefore reported more than once in individual responses.

[71] The ratio was of 1:26 vs 1:2.3 for the number of investment vehicles.

managers it is 46. Note that overall, the median number of investment vehicles used by insurance undertakings is 58[72].

The range for the number of funds used by insurance undertakings is significant. At one end of the spectrum, evidence shows that almost one-third of insurance undertakings use 25 investment vehicles or less. At the other end, the thematic review found that less than 8% of insurance undertakings use more than a 1,000 investment vehicles. Similarly to the evidence regarding the number of asset managers used, the thematic review also found a positive correlation between the size of the insurance undertaking and the number of investment vehicles it uses, that is, **larger insurance undertakings tend to use a larger number of investment vehicles**.

In some cases, **the number of investment vehicles used is also, to some extent, influenced by the business or distribution model used by the insurance undertaking**. For instance, some participants have reported that they manage a significant number of individual or personalised portfolios. These are structured as investment vehicles managed by an asset manager or a banking institution in which the insurance undertakings invests on behalf of the policyholder. The unit-linked fund in which the policyholder invests is a one to one match with the fund in which the insurance undertaking invests. For the purpose of this thematic review the insurance undertakings have categorised these funds as underlying investment vehicles used in the structuring of unit-linked funds.

About 12.500 investment vehicles managed by external asset managers have been reported as being Private Placement Life Insurance (PPLI). If these were not to be considered as investment vehicles and were, therefore, disregarded in the above analysis, the difference between the number of investment vehicles managed by in-house asset managers and the number of investment vehicles managed by external asset managers would decrease but the results in terms of the median numbers of investment vehicles used would remain unchanged[73].

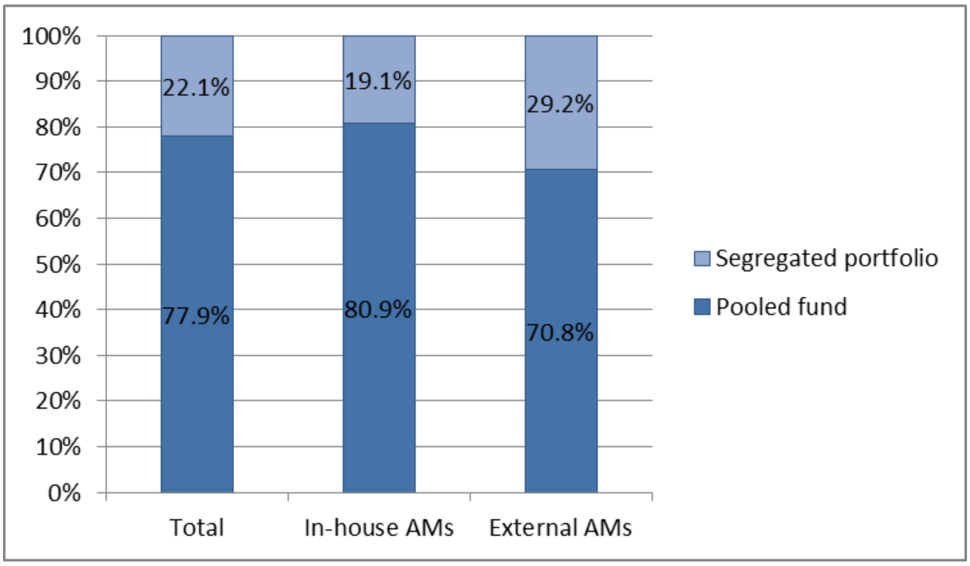
Distribution of assets per type of investment vehicle

The next figure shows the distribution of unit-linked assets per type of investment vehicle (i.e. pooled funds and segregated portfolios) for the entire sample, as well as for the assets managed by in-house asset managers and assets managed by external asset managers.

[72] Please note that this number does not necessarily equal to the sum of the other reported medians. This would only be the case under very uncommon data sets.

[73] This is mainly due to the fact that the median is not influenced by outliers.

Figure 15: Distribution of assets per type of investment vehicle



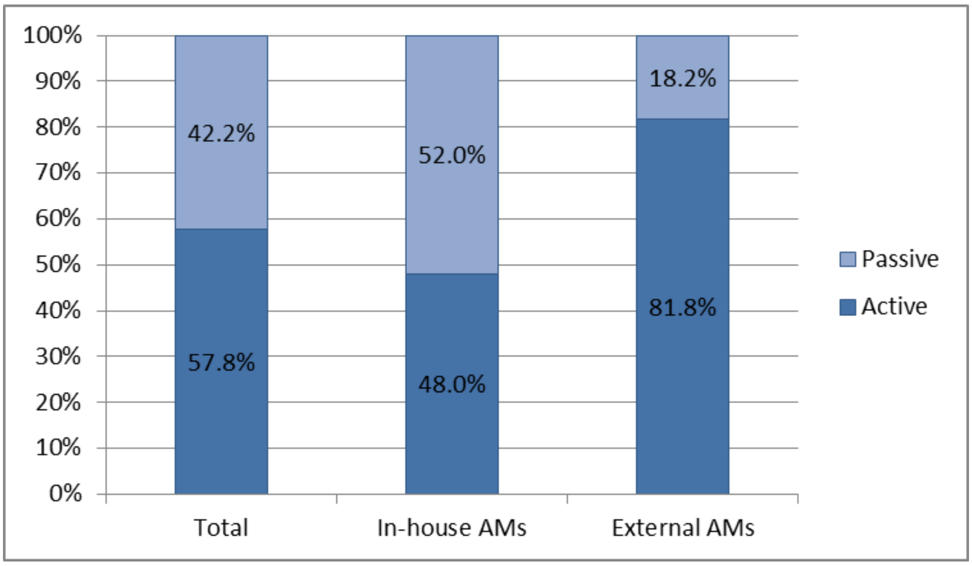
As the above figure shows, **most of the assets of unit-linked funds are invested in pooled funds**. The assets invested in pooled funds **represent circa EUR 1.4tr of the sample's assets and an estimated EUR 2tr for the entire unit-linked market**.

The predominance of pooled funds is particularly significant in the case of the assets managed by in-house asset managers, where pooled vehicles account for 81% of assets, whereas for investment vehicles managed by external asset managers the difference is not so accentuated but still relevant.

Distribution of assets per type of investment strategy

The next figure shows the distribution of unit-linked assets per broad type of investment strategy (i.e. active investment and passive investment) for the entire sample, as well as for the assets managed by in-house asset managers and assets managed by external asset managers.

Figure 16: Distribution of assets per type of investment strategy



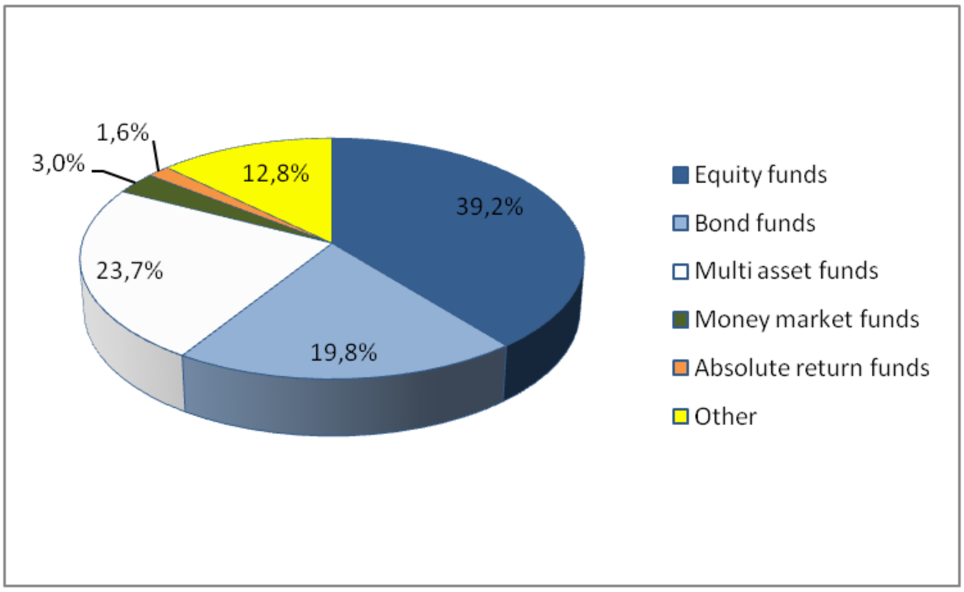
Gathered data shows that **almost 60% of the assets of unit-linked funds are invested in investment vehicles that pursue an active investment strategy**. The assets allocated to this type of investment strategy **represent circa EUR 1,1tr of the sample and an estimated EUR 1,5tr of the entire unit-linked market**.

The higher share of assets allocated to active investment strategies is **markedly more significant in the case of external asset managers**, where these investment strategies account for 82% of assets.

Asset classes

The next figure shows the distribution of the number of investment vehicles used per asset class. The fund class classification follows the European Fund Classification used by EFAMA – European Fund and Management Association which is summarised in **Annex V**.

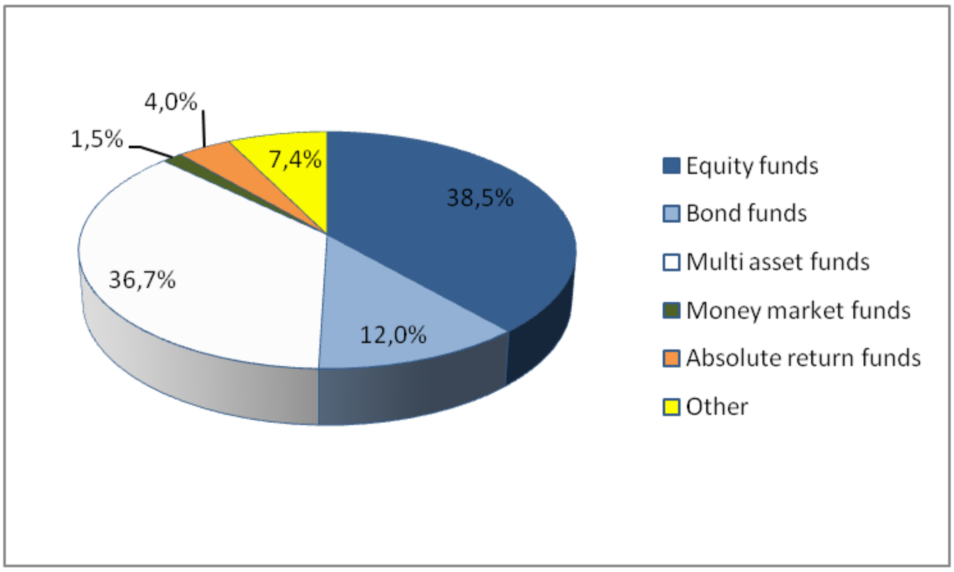
Figure 17: Distribution of number of investment vehicles per asset class



Evidence shows that **the assets of unit-linked funds are mostly invested in mainstream asset class types**. There are no indications at this level of aggregation of high volumes of investment in alternative or more complex assets, though the 12.7% of investment vehicles classified as "other" asset class would need further analysis as this still represents a significant range of non-mainstream assets being selected.

Similar conclusions can be drawn when considering the distribution of the assets of the sample of more than 1800 underlying investment vehicles used by insurance undertakings in the structuring of unit-linked funds, as shown in the next figure.

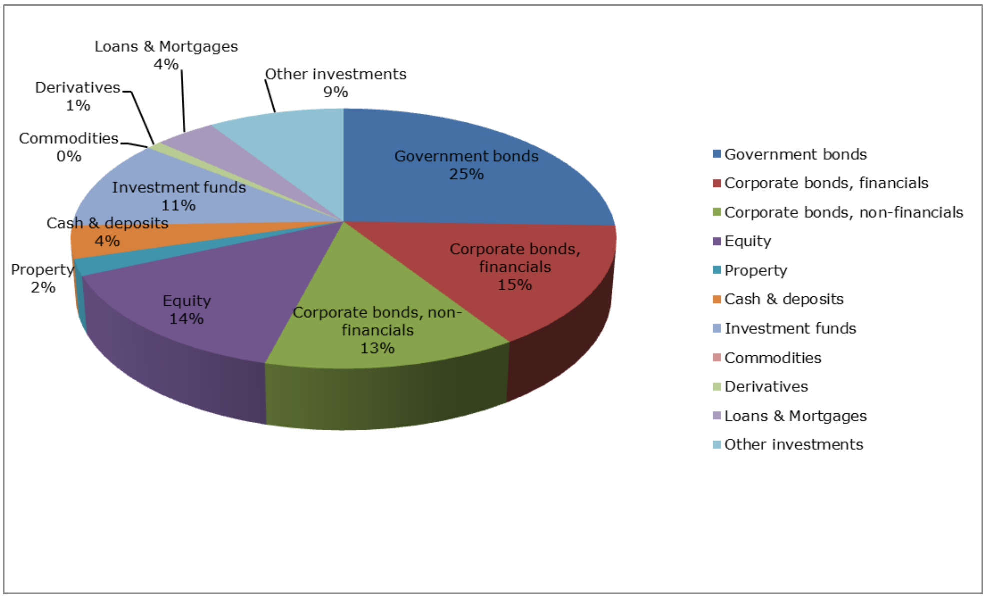
Figure 18: Distribution of assets of for sample of 1800 underlying investment vehicles



Although the above figure shows the value of assets invested in each asset class, which is not the same as the number of investment vehicles per asset class, both sets of data indicate that **insurance undertakings invest a significant portion of unit-linked assets in equity funds and multi-asset funds**.

The above results **show some similarities with the average composition of the investment portfolio of life insurance undertakings but also some marked disparities**. The next figure shows the average composition of the investment portfolio of the life insurance sector in Q4 2015.

Figure 19: Average composition of the investment portfolio of the life insurance sector in 2015



Source: EIOPA Financial Stability Report – June 2016[74]

Debt and fixed-income securities account for the highest share of the portfolio of life insurance undertakings, with total exposure to this asset class representing slightly more than half of total assets in 2015. This is unsurprising considering the liability profile of life insurance undertakings and the use of asset-liability-modelling techniques, i.e., selecting assets with predictable cash flows (e.g. debt and fixed-income securities) that match expected outflows (future insurance claims). The comparison indicates that **there seems to be a greater appetite for unit-linked products to invest in equity funds and multi-asset funds, mostly at the detriment of debt and fixed-income funds**.

Unit-linked funds offer

The previous sections considered the choices made by insurance undertakings regarding the management of unit-linked assets by looking at who manages the assets of unit-linked funds and at what asset managers, investment vehicles, investment strategies and asset classes are used. This section considers how these influence the unit-linked funds actually offered.

[74] Available at https://eiopa.europa.eu/Publications/Reports/Financial_Stability_Report_June_2016.pdf.

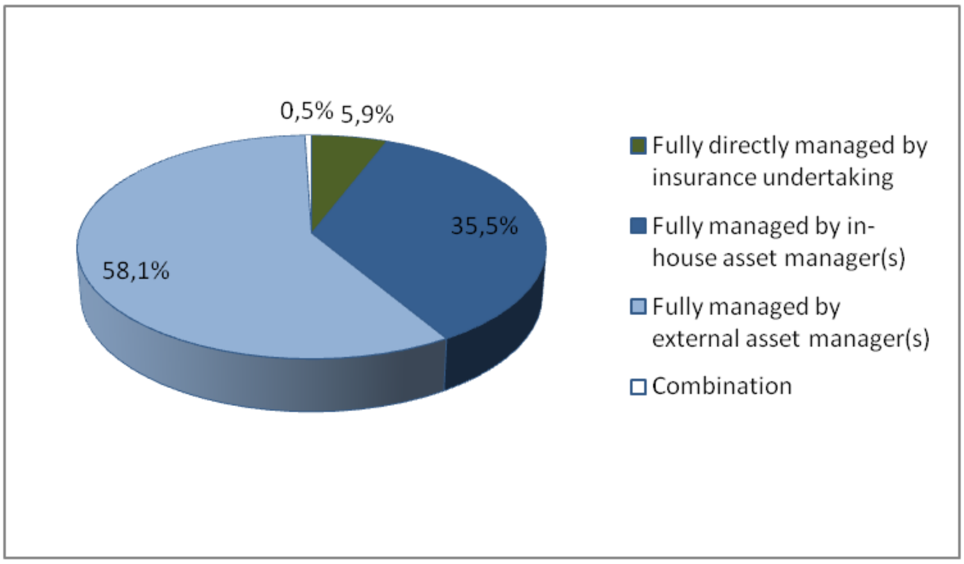
Consumers are impacted by the characteristics of the underlying investment vehicles selected by insurance undertakings at the level of the **risk-return spectrum** but also in so far as the **underlying funds are used to structure the undertakings' offering of unit-linked products**. Ultimately, the choices of insurance undertakings at the level of the underlying investment vehicles used impact the characteristics of the unit-linked funds themselves and the offering to current and potential customers.

Two elements are considered. The first concerns the asset management arrangement chosen, i.e., who manages the assets of the unit-linked fund. The second, the characteristics of the unit-linked fund itself.

Asset management arrangements

The assets of each unit-linked fund offered by insurance undertakings may be directly managed by insurance undertakings, or may be indirectly managed if insurance undertakings use one or a combination of external investment vehicles managed by either in-house or external asset managers. Insurance undertakings may also use various combinations of these arrangements. For instance, they may, for the same unit-linked fund, directly manage part of the assets and use a combination of in-house and/or external asset managers for the remaining assets. Evidence shows that **there are only a marginal number of unit-linked funds offered to policyholders that use combinations of different asset management arrangements**, as shown in the next figure.

Figure 20: Distribution of unit-linked funds per type of asset management arrangement



Data gathered does not directly allow us to conclude on the possible existence of unit-linked funds that combine the services of different asset managers (whether in-house or external). For instance, within the 57% of unit-linked funds that are fully managed by external asset managers, a single unit-linked fund could potentially use more than one external asset manager. However, as described before, the vast majority of participating insurance undertakings use a small number of asset managers and a more granular analysis suggests that, indeed,

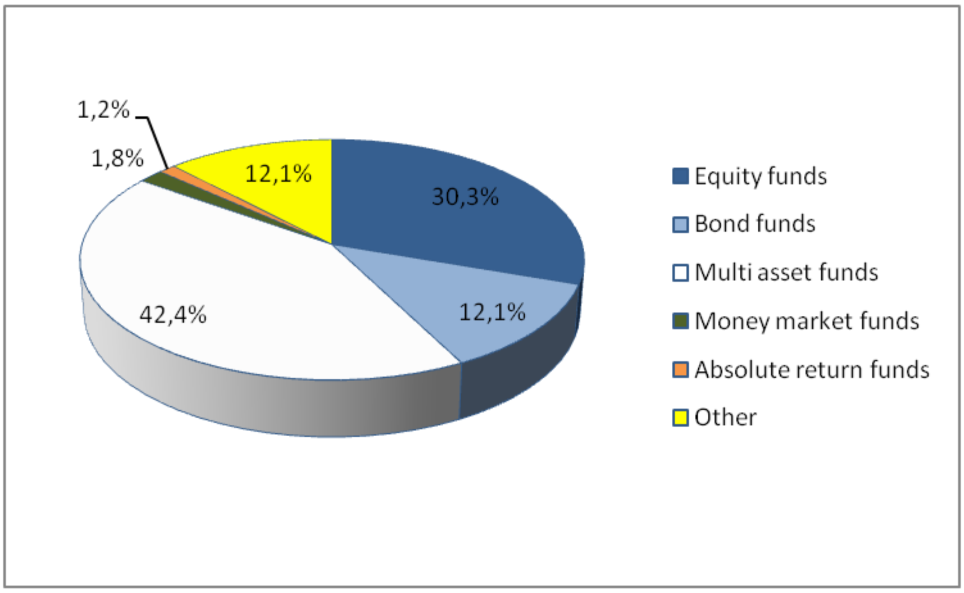
individual unit-linked funds offered by insurance undertakings are mostly managed by a single asset manager, with the **unit-linked fund that is offered "mirroring" the asset manager's investment vehicle**, which is held by the insurance undertaking.

Characteristics of unit-linked funds

Regarding the characteristics of the unit-linked funds offered to customers, two elements have been considered: (i) the asset class the unit-linked fund invests in and (ii) the type of investment strategy. This mirrors the assessment at the level of the assets that are underlying the unit-linked funds.

The next figure shows the distribution of the number of unit-linked funds offered per asset class.

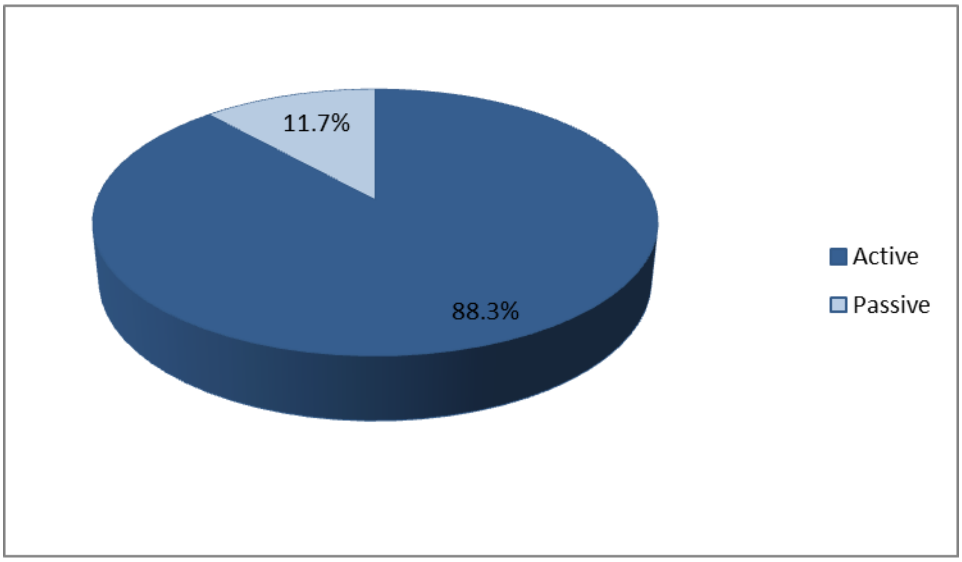
Figure 21: Distribution of unit-linked funds per asset class



The distribution is particularly close to the distribution of investment vehicles per asset class reported before. The significant difference is a **higher number of multi-asset funds (+19%) which is mostly compensated by a reduction in the number of bond fund (-9%) and equity funds (-8%)**.

A strong parallel may also be set between the distribution of unit-linked funds per type of investment strategy and the distribution of investment vehicles per type of investment strategy. In both cases the number of investment vehicles and **unit-linked funds pursuing an active investment strategy is significantly higher than those pursuing a passive investment strategy**.

Figure 22: Distribution of unit-linked funds per type of investment strategy



Prevalence of monetary practices

As has been noted, the evidence shows that, overall, **in-house asset managers tend to pay the most monetary incentives and remuneration in absolute terms but external asset managers pay more in relative terms**[75]. This raises questions regarding why this is the case.

As seen before, different elements come into play in determining the monetary incentives and remuneration obtained from a particular asset manager or a particular investment vehicle. For instance, it has been observed that higher monetary incentives and remuneration are received or obtained from investment vehicles pursuing active investment strategies. In addition, external asset managers also tend to manage a higher share of investment vehicles pursuing active investment strategies. Therefore, **it may be the case that the higher level of monetary incentives and remuneration obtained by external asset managers is mostly due to the type of investment strategies pursued; not due to, *per se*, the type of asset manager**. The nature of any causal relationship here however would depend on the factors that are determining the choice of asset managers by the insurance undertakings (are they seeking certain investment strategies, or are they seeking certain levels of remuneration?).

Further considerations as to the level of monetary incentives across the two types of asset managers considered would require additional granular data, given the causal complexity here. This analysis would also have to take into account the significantly larger number of external asset managers used and, implicitly, the number of investment vehicles managed by external asset managers.

[75] In relation to the value of assets under management.

Nonetheless, based on the set of data currently available, it is possible to draw some meaningful conclusions on how widespread the monetary practices are across the two types of asset managers.

Overall, **61% of asset managers pay some sort of monetary incentives and remuneration to insurance undertakings**[76]. The prevalence of these monetary practices seems to be similar for both types of asset managers[77].

Note that this does not imply that 61% of asset managers pay some sort of monetary incentives and remuneration for all the investment vehicles they offer as they could be paying monetary incentives and remuneration only for some of the funds they manage. This is indeed the case. The percentage of investment vehicles paying some sort of monetary incentives and remuneration is lower, as expected, at 33%.

While **39% of investment vehicles managed by external asset managers pay some sort of monetary incentives and remuneration**, the percentage of vehicles managed **by in-house asset managers** that pay some sort of monetary incentives and remuneration **is lower at 18%**.

The most significant difference when comparing by type of asset manager is that, **in 80% of cases, all of the in-house asset managers used by a particular insurance undertaking pay some sort of monetary incentives and remuneration** (even if not for every investment vehicle[78]), **whereas for external asset managers, this percentage is 42%**.

Sources of potential consumer detriment

The way insurance undertakings manage assets of unit-linked products generates sources of potential consumer detriment. Evidence indicates that **insurance undertakings tend to use relatively simple arrangements** where most of the assets are managed by a small number of asset managers, and where units offered map directly to underlying funds.

Although simple and streamlined asset management approaches have their merits, **more complex or comprehensive approaches may also have the potential to produce better results over the long-term** and, therefore, enhance consumer outcomes. More complex approaches are designed with the objective to take full advantage of the merits, capacities and relative advantages of different asset managers. This could be through structures that combine a number of asset managers through different asset classes, investment styles, etc. The purpose is to select the most relevant or competitive asset managers for each investment class/investment strategy which may be also combined with internal asset management capacities. A complex asset management structure may, for instance, be one where the insurance undertaking directly manages a

[76] This compares with 80% of insurance undertakings receiving some sort of monetary incentives and remuneration.

[77] 60% and 61% of, respectively, in-house and external asset managers pay some sort of monetary incentives and remuneration to insurance undertakings.

[78] The percentage of undertakings where all investment vehicles managed by in-house investment pay some sort of monetary incentives and remuneration is 52%. This percentage is 36% investment vehicles managed by external asset managers.

bond portfolio on a passive basis and relies on a group of asset managers to actively manage mandates for other asset classes.

Evidence shows no indication of such asset management structures being broadly used. In fact, evidence essentially shows a contrary tendency with most insurance undertakings not managing assets at all, and relying on a limited number of asset managers. It is highly **unlikely that a single asset manager will be the most relevant or competitive asset manager across the entire range of asset classes or fund strategies or is able to relentlessly and uniformly outperform its peers**. There are, therefore, concerns that consumers may not be getting access to the most relevant or competitive funds.

Although the purpose of the thematic review was not to assess performance of unit-linked funds, performance data was reported for the sample of more than 1800 underlying investment vehicles used by insurance undertakings in the structuring of unit-linked funds. This information shows that **35% of the underlying funds used by insurance undertakings have underperformed their benchmark for at least half of the quarters during the period 2013-2015**. More granular data would need to be considered to fully assess how each asset manager performs against its peers and benchmark across the entire range of asset classes and funds it manages but available data indicates that investment outcomes could be enhanced.

A simple asset management structure relying on a small number of asset managers may also be a source of potential consumer detriment in so far as **consumers may be provided with limited choice of available funds**. This may result in customers not having access to the funds that would best suit their needs. Insurance undertakings, acting in the best interests of customers, should provide a sufficient range of different products which are sufficiently high in quality, to ensure that the customer's investment objectives can be suitably met, taking into account the market the insurance undertaking is targeting.

Moreover, **there may be issues where funds offered are limited to those provided by one or a limited number of asset managers**, irrespective of quality. Consumer detriment may be further amplified when insurance undertakings have a stronger incentive, or may be bound by group-level agreements, to select funds from an in-house asset manager(s) or an external asset manager(s), or to focus on a certain selection of these funds that are more highly remunerative for the financial group, irrespective of their performance or "value for money".

The **risk of consumer detriment would be significantly increased if insurance undertakings chose underlying investment vehicles on the basis of those which provide them the highest level of monetary incentives and remuneration**. Although the level of remuneration is not explicitly indicted by participants as a selection criterion, insurance undertakings may display certain behaviours that hint at the existent of such risk or lead to a result consistent with this practice.

The **thematic review does not attempt to establish a causal link between the level of monetary incentives and remuneration and chosen underlying investment vehicles**. To do so in a definitive manner would require a more extensive analysis, modelling value chains and decision processes for different insurance undertakings across different markets.

The **results of the thematic review do, however, indicate a simple but strong correlation between these two variables** based on quantitative and qualitative input provided by industry.

If insurance undertakings are led to choose underlying investment vehicles based on the highest remuneration received, and since remuneration received by insurance undertakings is normally a proportion of fund management charges, insurance undertakings would be inclined to select underlying funds whose investment strategies imply higher fund management charges.

As described before the most critical elements in determining the level of fund management charges, and consequently, monetary incentives and remuneration are the characteristics of the investment vehicle itself, not so much the type of asset manager. Overall, qualitative input from participants indicates that fund management charges tend to be higher for funds that pursue an active investment strategy, and for funds that invest in more risky asset classes (equity funds and multi-asset funds).

Evidence clearly shows that the funds with higher fund management charges are the investment vehicles mostly used by insurance undertakings in structuring unit-linked funds and, consequently[79], in their offer to policyholders. **Even if resulting from an implicit motivation, insurance undertakings tend to select those investment vehicles from which higher remuneration is received**.

The relatively low share of directly managed assets indicates that most insurance undertakings fully rely on external entities for the management of unit-linked assets. Although there should be no prejudice *vis-à-vis* such a business model, **significant consumer protection issues may arise if no strong safeguards from a governance perspective are put into place**. Insurance undertakings are increasingly outsourcing functions associated with the unit-linked business[80]. Failings in the oversight of outsourced services providers may ultimately lead to consumer detriment. As far as the management of assets by external parties is concerned, it is **critical that insurance undertakings have in place strong processes for the selection and monitoring of asset managers and investment vehicles**. This will be considered in the next section of the Report.

The choice of the most relevant or competitive underlying investment vehicles in the structuring of unit-linked funds is part of the insurance undertaking's fiduciary duty and duty to act in the best interests of customers. However, most insurance undertakings in structuring individual unit-linked funds do not actually use a combination of underlying investment vehicles. **They rather operate, in respect of the units offered in unit-linked contracts, as distributors of pooled funds managed by in-house or external asset managers,** with no significant divergence (at the level of the units) between units offered and funds used to underlie them. In this capacity, insurance undertakings, acting in the best interests of customers, **should ensure that the appropriateness of their offer to policyholders is regularly assessed**.

In this context, an approach can emerge where the insurance undertaking views its role as largely that of a distributor of investments that are the responsibility of other parties, though the insurance undertaking is selecting which

[79] Essentially due to the prevalence of a distribution business model.

[80] E.g. operational functions such as pricing/valuation activities.

investments to offer, and is offering these investments in a form (units in a unit-linked life insurance contract) that is not identical to the underlying investments. In terms of consumer protection, this **can contribute to continued reported issues around poor transparency and disclosure of information already reported in EIOPA's Consumer Trends Reports**.

Furthermore, it raises questions about consumers' effective ability to choose the product that best suits their needs in light of wider product offering and increasing complexity. Indeed, ordinary consumers do not always behave as the so-called perfectly rational consumer ("homo economicus") who reads terms and conditions, makes optimal purchasing decisions and have a perfect knowledge of the market.

C. Addressing conflicts of interest & acting in the best interests of customers

Key takeaways

- Insurance undertakings generally **have formal policies to ensure that they act in the best interests of customers**, with specific reference to conflicts of interest that might arise in the course of unit-linked business. However, **actual practices under these formal policies vary significantly**.
- **69% of undertakings do not disclose** monetary incentives and remuneration received to policyholders.
- **61% of undertakings retain** monetary incentives and remuneration received.
- **25% of undertakings pass on in full** monetary incentives and remuneration received; this represents 30% of total monetary incentives received.
- The **selection of asset managers and investment vehicles does not always follow a comprehensive process**. The selection is, in some cases, **constrained by existing business relationships with asset managers**;
- **25% of insurance undertakings do not have a formal process for selecting investment vehicles** while **31% do not have monitoring processes**. In these cases they tend to delegate these responsibilities to asset managers.

General principles for addressing conflicts of interest

Various conflicts of interest can arise in the course of unit-linked business in regards to the relationships between insurance undertakings and asset managers, in view of monetary incentives and remuneration arrangements between them.

To assess how insurance undertakings address such conflicts of interest, **participants were asked to indicate what policies they have in place to ensure that they act in the best interests of customers**, with specific reference to conflicts of interest that might arise including, but not restricted to those between:

- Shareholders and customers[81];
- The interests of different customers in different funds[82];
- Different generations of policyholders within a single fund[83];

[81] E.g. seeding of unit-linked funds and box management.

[82] E.g. with-profits and unit-linked customers.

- Different companies part of the same group of companies[84];
- Different interests of employees or directors and customers[85].

The thematic review did not seek to examine in practice how effective the participants' policies in respect of conflicts of interest may be. The purpose was to, overall, **assess the extent to which insurance undertakings identify the existence of potential conflicts of interest and to what extent they have policies and processes in place to identify and mitigate such conflicts**.

There was a **wide range of responses**, including many from undertakings with comprehensive risk management and governance processes surrounding conflicts of interest. Examples of such comprehensive processes are indicated below.

Example 1

The undertaking has a "Managing Conflicts of Interest Policy" whose goal is to prevent occurrence and development of conflicts of interest and mitigate reputational risks. The policy covers issues pertaining to potential and actual conflicts between the undertaking or a person related to the undertaking and customers, between two or more undertaking's customers, between the undertaking and a person related to the undertaking. The policy also regulates registering potential or actual conflicts of interest, managing a conflict and informing the customer about potential or actual conflicts of interest.

Example 2

[...] operates within an overarching Conflicts of Interest (COI) policy, and this is supplemented by a Funds' specific COI policy which addresses the potential conflicts of interest in relation to the funds, e.g. between shareholders & clients, different generations of policyholder etc. The policy articulates the different conflicts that could arise and the mitigants in operation; it also sets out governance structure in place over the management of funds conflicts, including the recording and reporting of conflicts and the requirements for formal annual declarations of conflicts by all middle/senior management with responsibility for the management of the group's funds.

However**, there were also undertakings reporting that, in practice, such conflicts of interest did not arise in their individual situations**, even where other insurance undertakings appeared to take a contrary view. Often there was

[83] E.g. differing policy terms.

[84] E.g. where services are outsourced within the same group of companies, including asset management, instead of externally.

[85] E.g. sales incentives.

not sufficient detail provided to assess the statements. Examples of such responses are indicated below.

Example 1

As we only sell funds from [our own Member State's] savings bank sector and only one asset management company (belonging to our sales partners), there are no conflicts of interest.

Example 2

There are no conflicts of interest due to policy terms of investing procedure.

The **inconsistencies in approach raise concerns as to the extent to which consumers will in practice be able to rely on robust management or mitigation of conflicts of interest**. It is expected that the conflicts of interest and product oversight and governance measures foreseen in the IDD will drive further improved attention to this important feature of the fair treatment of customers and will increase the awareness among senior management of insurance undertakings of the conflicts of interest that could arise in respect of the unit-linked business and relations with asset managers.

It is perhaps not surprising that **undertakings with a multinational presence** operating on a multi-regional or global basis will **have more comprehensive policies in place in order to meet the highest requirements of the various regulatory jurisdictions in which they operate**. Such groups will then tend to implement these policies on a group-wide basis. Smaller insurance undertakings which operate within a single Member State may not have the same degree of focus on this issue.

Box management and the seeding of new funds

In respect of box management in a dual priced fund, where there are buyers and sellers of the same fund on the same day, buy and sell orders can be matched with each other without incurring the transaction costs equivalent to those priced into the bid-offer spread. This can save money as the transfer can be completed by passing all of the dealing of the units through the "manager's box".

However, **some asset managers may retain the resultant profit arising from the spread itself which the client has already paid** (in the spread) but will not be spent transacting in the market.

This is likely to be an issue more for asset managers themselves than for the insurance undertakings that place their policyholders' money with the asset managers. Still, and most importantly, **it is an issue that insurance undertakings should be aware of in considering the costs to policyholders** and the potential benefits of sharing such box management profits more widely, where generated.

There was relatively little evidence provided in respect of these particular aspects of unit-linked funds, which naturally feature more prominently in some markets than others, with some participants simply indicating the inexistence of seeding of unit-linked funds and of box management. **Some participants, nevertheless, indicated that they are aware of these issues** and, recognizing the potential impact for policyholders, **have implemented adequate procedures**. An example of such a response is indicated below.

Example 1

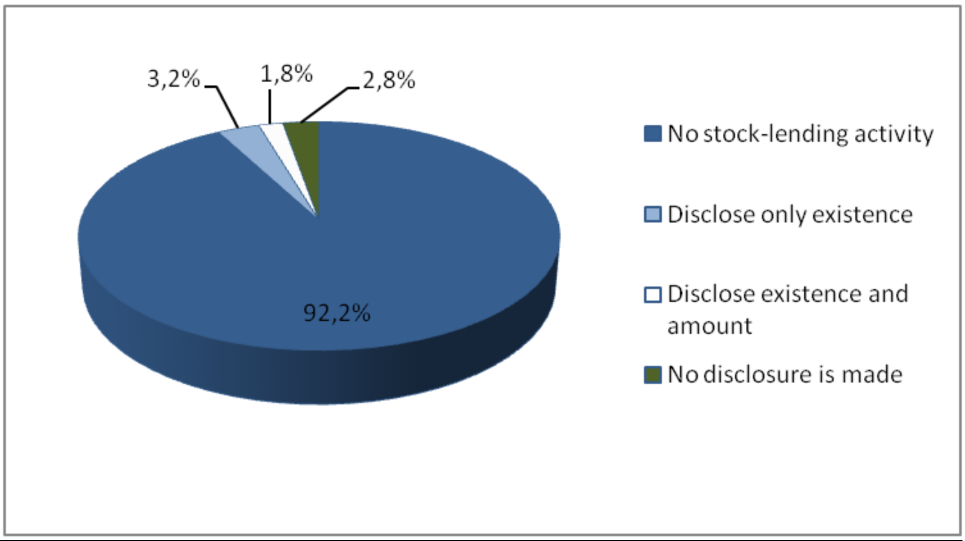
From a shareholder's perspective: we have defined box management processes designed to manage conflicts. We also consider at the outset of a fund what the seeding arrangements need to be, including repayment of capital. We have not allowed capital to be repaid without first agreeing that doing so is aligned to the customer's interest.

Stock lending activity

Stock-lending activity is an additional source of income for large institutional investors, including insurance undertakings. The practice can aid price discovery and is therefore consistent with properly functioning markets. Stock-lending (also called securities lending) involves the lending of securities such as stocks and shares. This has a benefit to the insurance undertaking (as lender of the stocks) because of the fees that can be charged, while the borrower can use the stock as part of its investment strategy. This introduces an element of credit risk to the insurance undertaking in the event that the borrower defaults or is otherwise unable to return the stock, although this can be mitigated by obtaining collateral against such an event.

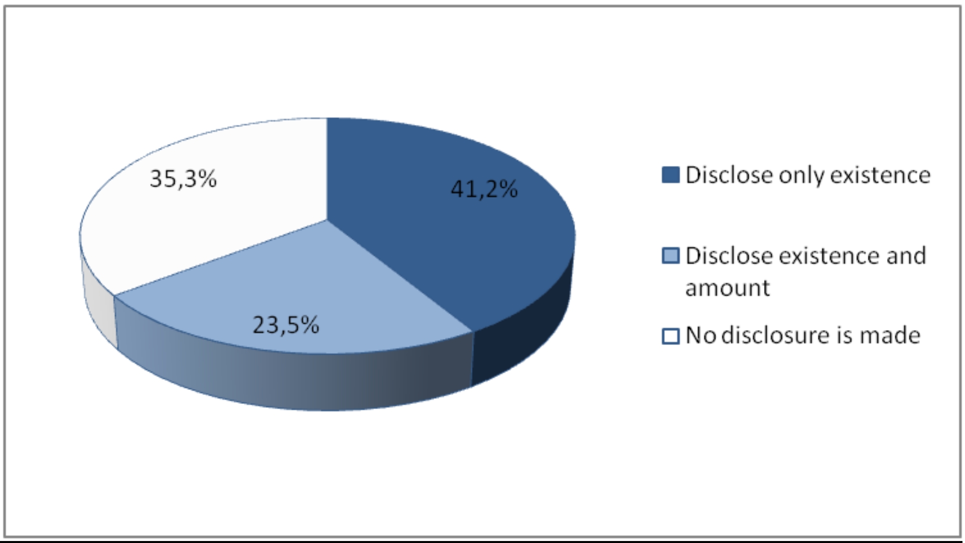
As can be seen from the next figure, this is **not in practice a widespread feature** among insurance undertakings participating in the thematic review.

Figure 23: Share of participants disclosing revenues received from stock-lending to policyholders



However, among those insurance undertakings that do generate additional income via stock lending, 35% make no disclosures about the existence of such practices or the amounts involved, while less than one quarter disclose the existence of this practice as well as the amount of revenue obtained from stock lending. In over 75% of cases it is the policyholders' funds that bear the risk of default. This is reported in the diagram below.

Figure 24: Share of participants disclosing revenues received from stock-lending to policyholders

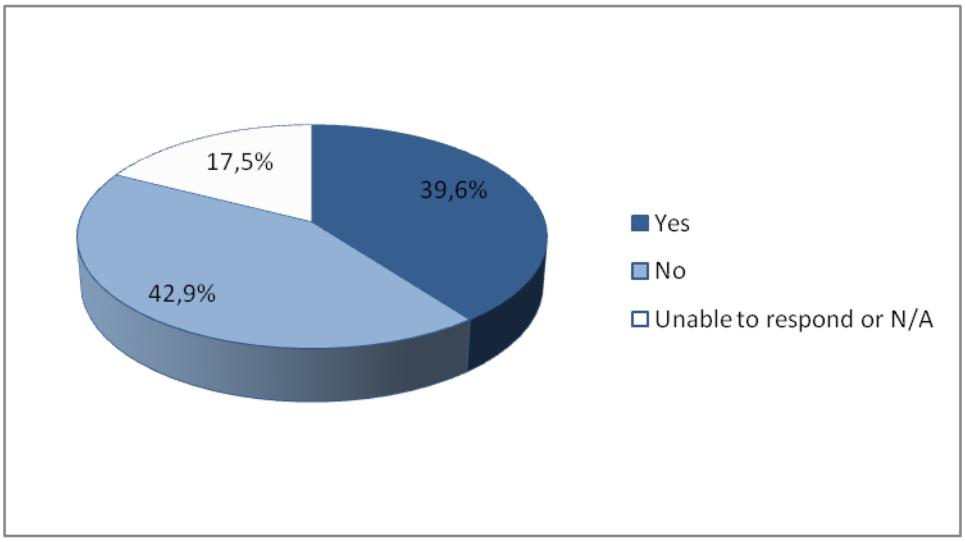


Share class used

Participants were asked whether or not they invest in share classes specifically designed for institutional investors. The purpose is to explore: (i) whether economies of scale can be available to large insurance undertakings through investment with lower fees than those available to retail investors and (ii) the degree to which this operates in practice and the extent to which any such benefits are shared with the retail policyholders or retained elsewhere within the value chain.

Alternatively, higher fees may be charged in order to access investments that may not normally be available to retail investors but which could act as part of a balanced portfolio of investments and hence reduce volatility in returns.

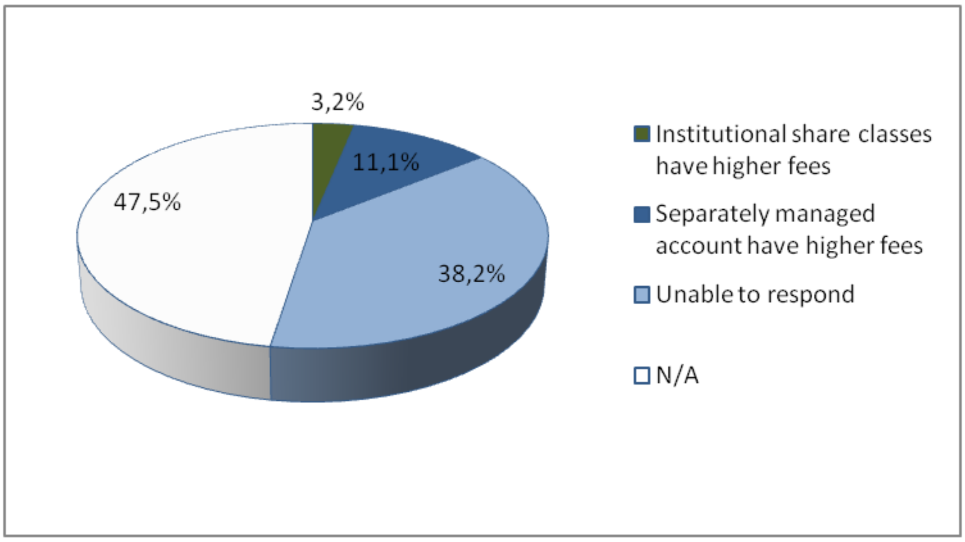
Figure 25: Share of participants investing in share classes specifically designed for institutional investors



While a **significant proportion of undertakings (39%) indicated that they use institutional share classes for retail investors**, further work would be necessary to ascertain the costs and benefits of this practice, as the figure above demonstrates.

In addition, **there are small percentages of participants indicating higher fees for institutional share classes or separately managed accounts**. The majority of participants have actually indicated either that they are unable to respond or that this is not applicable to them. These results are presented in the next figure.

Figure 26: Comparison of fees paid on institutional share classes vs separately managed account

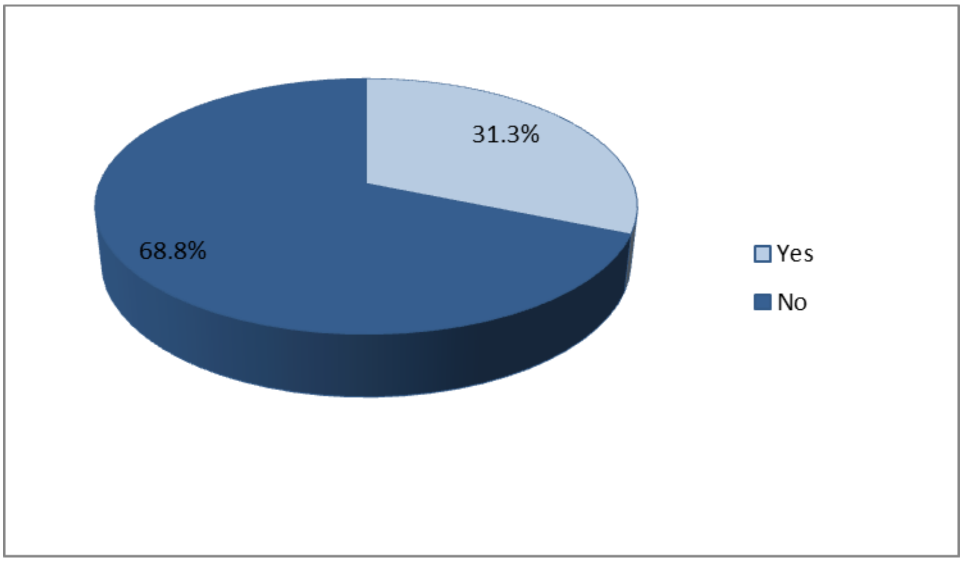


Disclosure

Where conflicts of interest are identified and are not subject to appropriate mitigation, whether because they are inherent to the proposition, or because mitigation is not appropriate for other reasons, it is best practice to disclose such conflicts of interest to policyholders. The existence of monetary incentives and remuneration have been reduced in jurisdictions where commissions have either been removed from the market place or are tightly regulated, while in other jurisdictions they remain central to existing distribution models.

As indicated in the next figure, **only around one-third (31%) of participants reported disclosing to policyholders any monetary incentives and remuneration received**.

Figure 27: Share of participants disclosing monetary incentives and remuneration received to policyholders



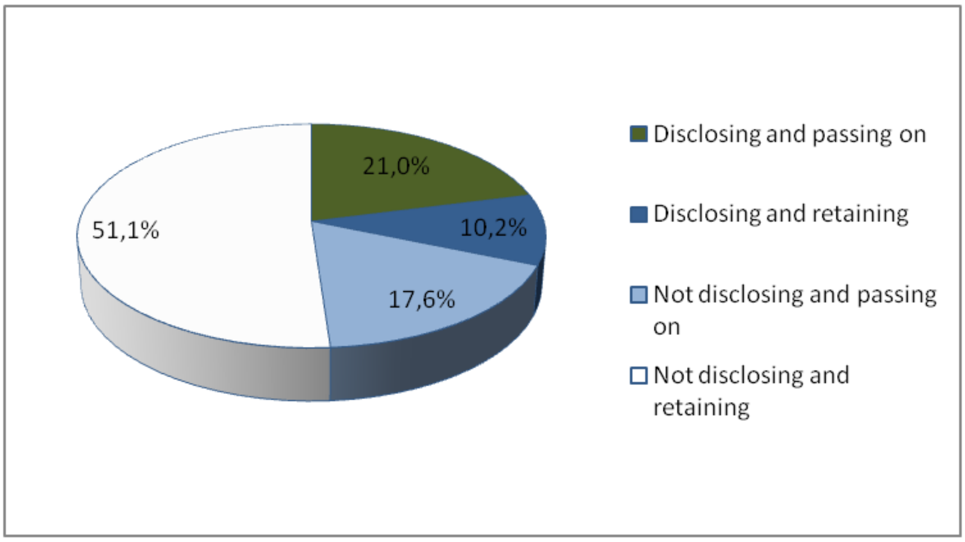
Of those participants that made these disclosures, **60% did so as a result of legislation in force, while the remaining third did so on a voluntary basis**. Where disclosures to policyholders are made, over 91% went to all policyholders automatically, with the remaining **9% of undertakings making these disclosures only on request**.

Nearly all undertakings (91%) made consistent disclosures rather than vary them by type of policyholder. There was a much more even split in terms of whether disclosures consisted of both the existence and the amount of monetary incentives and remuneration disclosed (48%) or whether **undertakings limited themselves to disclosing only the existence of such benefits (52%) without further quantifying them**.

Rebate of economic benefit to policyholders

The following figure shows the share of participants that passed on the value of monetary incentives and remuneration to policyholders as well as those that retained them.

Figure 28: Share of participants disclosing and/or passing monetary incentives and remuneration received to policyholders



Evidence indicates that all four possible combinations are present in the market. As such, **it should not be assumed that when not disclosing, insurance undertakings are not passing on the value of monetary incentives and remuneration to policyholders**. In the same vein, it should not be assumed that when disclosing, insurance undertakings are automatically passing on the value of monetary incentives and remuneration to policyholders.

It should also be noted that not all of the 39% of insurance undertakings that pass on the value of monetary incentives and remuneration to policyholders, do so in full. Indeed, 62% of the insurance undertakings that pass on the value of monetary incentives and remuneration do so in full, while 38% only pass on a part of monetary incentives and remuneration received.

In monetary terms, **the 20%[86] of insurance undertaking that pass on in full the value of monetary incentives and remuneration to policyholders account for 30% of the total amount of monetary incentives and remuneration received**. As such, **of the EUR 3.7bn of monetary incentives and remuneration received or obtained, EUR 1.1bn is passed on in full to policyholders**[87].

---

[86] Or 25% if only the number of insurance undertakings receiving or obtaining some sort of monetary incentives and remuneration is considered.

[87] The estimate for the entire market is EUR 1.8tr.

Fund manager selection

One of the areas of potential conflicts of interest that may be a source of potential consumer detriment is the balance between insurance undertakings with in-house asset management subsidiaries and those reliant on external asset managers. The potential conflicts of interest may, for example be related to:

- How insurance undertakings assess whether their in-house asset management offering is providing value for money for their policyholders;

- How, if at all, insurance undertakings encourage competition for managing their funds by periodically reviewing mandates and using market testing to identify whether the in-house asset manager remains the optimum provider of services to their policyholders.

Most participants indicate a logical approach to the initial selection of an asset manager. These included both qualitative and quantitative factors.

Examples cited included but were not limited to:

- Track record (typically five years of operating history with assets under management of at least EUR 5bn);
- Compliance culture[88];
- Breadth, depth and tenure of the management team;
- Turnover of key personnel;
- Size of investment team;
- General assessment of operational, research and trading capabilities;
- Recent client turnover and impact on the firm;
- Business continuity arrangements.

Having run through the quantitative screening and qualitative assessment, a short list can then be drawn up of suitable asset managers and due diligence conducted on each leading to a final recommendation.

At the same time, **a minority of undertakings reported that their choice of asset manager was driven exclusively by a strategic relationship**, often with a bank that also acted as the main distribution channel for its unit-linked products.

This alternative sort of approach may or may not deliver good value for consumers, but it may present considerable challenges from both a conflicts of interest perspective and in terms of demonstrating that it delivers fair investment outcomes to consumers. For example, it puts into question whether the Board of the insurance undertaking can exert effective challenge to the bank

[88] As demonstrated by the asset manager's capabilities and track record (e.g. analysis of a firm's pending, current and past legal, regulatory or compliance issues).

that it is dependent on for distribution and for its asset management, to deliver value for money. There would have to be very robust and independent management to deliver such an arrangement in these circumstances.

Competition for new asset management mandates

Among the participating insurance undertakings, only **11% said that they periodically put asset management contracts for the management of assets of unit-linked funds out to tender**, inviting bids from external asset managers outside of the group of companies to which the insurance undertaking belonged.

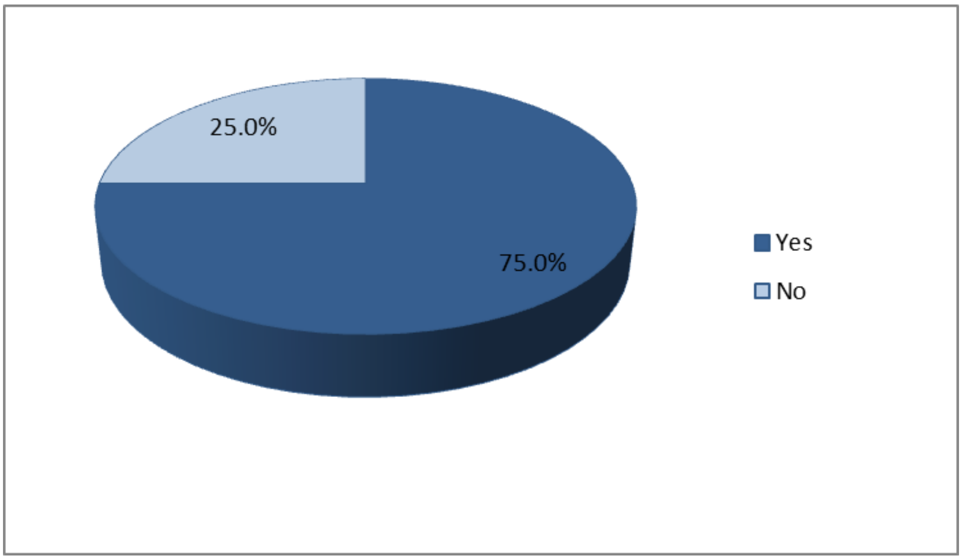
The concern this raises is that **underperformance from in-house or longstanding external asset management relationships may not be delivering value to policyholders**. As one participant said: "[…] no need for replacement of investment vehicles occurred, so the company has no experience in this area." This may be because the return to policyholders net of charges over time was such that a change of investment vehicle or asset manager was deemed unnecessary in view of policyholder expectations, but the concern must be acknowledged that there are significant variations over the extent to which insurance undertakings view themselves as having ongoing duties in regards to the asset allocations of existing policyholders in respect of unit-linked business, or the provision of appropriate offers that are in the best interests of potential policyholders, in view of new business. In both cases, product oversight and governance principles indicate more extensive expectations as to the responsibility of the insurance undertaking in these cases.

Another aspect of performance and competition here is the relative importance of asset manager selection versus fund selection. While we asked insurance undertakings about both aspects, we also note that while there could be a benefit to increased scrutiny of asset managers, this should not come at the expense of appropriate asset allocation decisions within an asset management relationship. It must be acknowledged that **strategic investment decisions such as asset allocation can have as significant an impact on ultimate returns to policyholders as manager selection**.

Selection of investment vehicles

75% of participants indicate that they have formal processes in place for the selection of investment vehicles used in the structuring of unit-linked products.

Figure 29: Share of participants having formal selection process



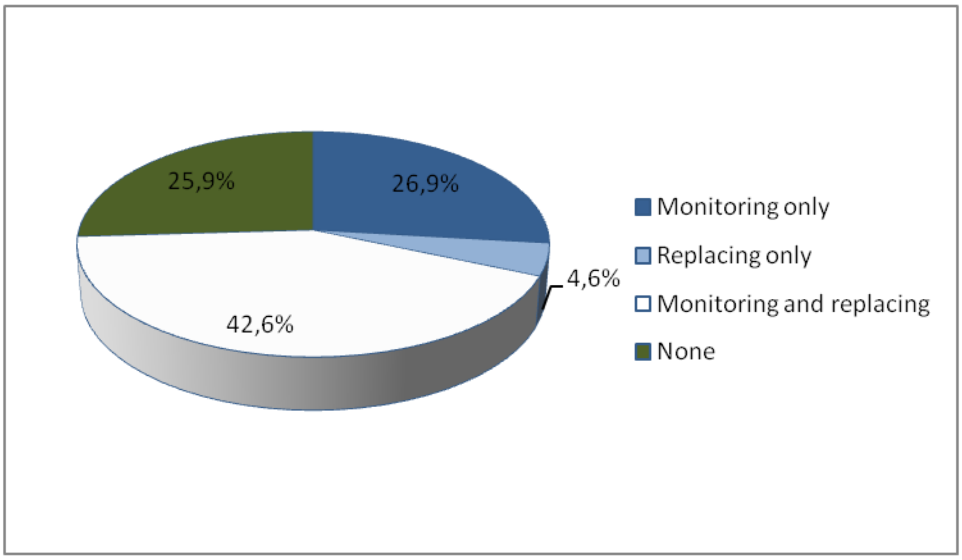
For the selection of investment vehicles, **insurance undertakings rely on both quantitative and qualitative factors**. These factors include elements directly related to the asset manager itself (e.g. credibility and reputation of asset manager, volume of assets under management, quality of investment process, etc.) as well as more quantitative elements specifically relating to the investment vehicle itself (past performance, charging structures, external ratings, size of the fund, etc.).

Worth noting is that **some insurance undertakings indicate that they also assess investment vehicles considering the expected sales volume and the expected level of fees for the undertaking itself**. Most commonly, insurance undertakings indicate that they **select new funds considering the existing offer of funds to policyholders**, specifically how new funds fit with their current range of funds so that policyholders are able to choose from a range of funds with various risk levels, asset classes, investment strategies, etc. The above elements are consistent with the distribution model in which some insurance undertakings operate.

Monitoring and replacement of investment vehicles

Considering the number of participants that have formal processes for fund monitoring and replacing, similarly to the above, about **one-quarter of insurance undertakings have no formal processes in place, while less than half have formally implemented both monitoring and replacement processes**.

Figure 30: Share of participants having formal monitoring and replacing processes



The **inexistence of these processes is often explained by the fact that these are centralised within the group** to which the insurance undertaking belongs or, on the case of regular monitoring, simply **delegated to the asset manager of the respective investment vehicle**. The delegation of the monitoring activities to other parties implies that insurance undertakings should have strong governance and oversight of these delegated responsibilities and activities. The thematic review did not seek to assess how insurance undertakings carry out their governance and oversight functions.

It would also be expected that, as part of their fiduciary duty, insurance undertakings directly monitor the performance of the funds they invest in or, at least, are provided by the asset manager with information on that performance when not performing independent monitoring.

Evidence collected for the largest investment vehicles used by each participating insurance undertaking shows that this is not always the case. Considering only those investment vehicles where a benchmark is defined (78% of the underlying investment vehicles), **participants were unable to report on the performance against the benchmark for 25% of those funds**, indicating that this information is either not collected (14%) or is not made available by the asset manager (10%).

However, **when existing, fund monitoring processes are generally structured and comprehensive**. Insurance undertakings tend to monitor the same type of fund measures and statistics they use for the selection process.

The performance of the investment vehicle is referred as a key element assessed on a regular basis.

A benchmark can be used for monitoring and assessing the performance of an investment vehicle against the expectations of both the insurance undertaking and the policyholder. In either situation valuable information can be obtained through the judicious use of benchmarks and there are clear benefits for all concerned. Appropriate benchmarks can be used to identify what and where improvements can be achieved, perhaps analyse how others achieve their performance, and also use the benchmark data to improve one's own performance. Of course, comparisons must be made on a like with like basis, whether that is based on peer size, the market sector invested in, region, or some other relevant metric.

The evidence gathered in the course of the thematic review shows that the use of benchmarks to assess performance of investments and asset managers does not appear to be as prevalent as might be expected. It emerged that **27% of the largest underlying investment vehicles do not have a predefined benchmark, or, if there is a relevant benchmark that could be used for the purpose, insurance undertakings are unaware of it**.

Clearly it is important that insurance undertakings monitor the performance of asset managers once they are chosen or that they review the arrangement on a regular basis to ensure that the arrangement is appropriate and fit for purpose. In the absence of insurance undertakings using a benchmark to monitor and assess the effectiveness of the asset manager, **some insurance undertakings have no objective basis on which to judge the performance of investment vehicles**.

Although important, fund performance is not the only criteria that participants cited when monitoring investment vehicles. Participants have also indicated that they look at additional aspects within the fund management process, such as risk controls, structural issues and other underlying causes of performance anomalies. These additional elements are normally not assessed with the same frequency as more quantitative elements such as performance.

The monitoring process itself may be a trigger for the replacement of investment vehicles. **Some participants have indicated that the replacement of investment vehicles undergoes a structured process when the performance of a fund becomes an issue**. Replacement processes generally involve higher scrutiny of the fund and the asset manager and, in some cases, an escalation process where senior management is involved and, if deemed appropriate, contacts with the asset manager to discuss the reasons for underperformance are undertaken prior to any concrete action being taken.

An example of such a process is described below.

Example 1

The performance of every fund within the investment universe is compared on a monthly basis by the risk management office with a pre-determined peer group represented by the Morningstar classification. Funds that had poor performance within their respective peer groups for a prolonged period of time are, then, inserted in the insurance undertaking's "Watch List". The allocation to a fund in the watch list cannot be increased and, if it remains in the watch list for a prolonged period of time, must be gradually reduced. If requested specifically, an analyst should provide a new fund that will replace the one redeemed or removed from the investment universe".

Some participants have indicated that they do not often change investment vehicles. As one participant said: "Our strategy is to keep the range of offered funds as stable and durable as possible. We are changing offered funds only if these are merged or closed. In such case the funds are replaced by other funds with similar strategy and fees structure". Other participants have indicated that changes fall within the sphere of the policyholders' decision: "Instead of replacing the funds it is up to the policyholders to switch between funds, according to his/her investment target and risk appetite".

The concern this "passive" approach raises is that insurance undertakings may hold for extended periods of time investment vehicles that are underperforming. As discussed before, it is unlikely that an investment vehicle is able to relentlessly outperform its peers.

Evidence collected for the largest investment vehicles used by each participating insurance undertaking shows that **57% of the investment vehicles have been held for at least seven years**. Regarding performance, participants have indicated that **35% of investment vehicles held for more than seven years have underperformed the benchmark in at least seven quarters during the last three years**, i.e., have posted more quarters of underperformance than of overperformance for the last three years. Although data gathered was restricted to a three-year period, and a longer time horizon might provide additional insight, together with the fact that **26% of the investment vehicles held for more than seven years have no formal benchmark**, this **raises concerns as to the ability of insurance undertakings to choosing the most relevant and competitive investment vehicles**. This is particularly significant considering that it is highly unlikely that an asset manager is able to continuously outperform its peer over the entire range of asset classes.

Sources of potential consumer detriment

The assessment of the general principles insurance undertakings have in place for addressing conflicts of interest reveals that, **overall, insurance undertakings have adopted general policies for the identification, mitigation and management of potential conflicts of interest**.

However, the **qualitative responses also indicate that applying these principles to the unit-linked business may, in some cases, fall short of**

the objectives of set principles, specifically in which concerns conflicts of interest between shareholders and customers. This originates from two main reasons. The first is the **apparent failure of some insurance undertakings to identify the existence and the nature of the potential conflicts of interest** that could arise in the unit-linked business. In particular, the potential conflicts of interest arising from the structuring of unit-linked products and the use of in-house and external asset managers. The second is directly linked to **how insurance undertakings handle monetary incentives and remuneration received**. Although most insurance undertakings indicate that they have policies in place relating to conflicts of interest, it is also true that most insurance undertakings receive monetary incentives and remuneration.

As indicated by some participants, a suitable handling of these monetary practices requires disclosure of such practices to policyholders. **This is not the general rule throughout the industry**.

Other participants indicate that a suitable handling of these monetary practices involves rebating the benefits obtained from such monetary practices to policyholders. Once more, this is not the general rule throughout the industry. It is not possible to determine if the inadequate treatment of the monetary practices is, in fact, due to their omission from formal policies, misinterpretation of existing rules our inadequate conduct. Independently of the reason, the general principles insurance undertakings have in place for addressing conflicts of interest seem, in some cases, inadequately deal with the monetary practices in place.

Disclosure is generally seen as an important element in promoting transparency for consumer financial products and services and ultimately contributing to consumer protection. The non-disclosure of such monetary practices is a source of potential consumer detriment. **Without full disclosure, the policyholder may not be aware of the split of fees/remuneration between the asset manager(s) and the insurance undertaking** or the actual overall level of the charges he/she is bearing. The policyholder may thereby **fail to take this into account when considering which unit-linked product to invest in**.

Although disclosure is key, **how information is provided to consumers should be a matter of concern**. Ordinary consumers do not behave as the so-called perfectly rational consumer (“homo economicus”) who reads terms and conditions, makes optimal purchasing decisions and has a perfect knowledge of the market. Suitable disclosure of these monetary practices would require consumers to know all parameters necessary for evaluating the remuneration structure prior to the conclusion of the contract. On the other hand, a contractual provision stating that “the insurance undertaking is entitled to possible kickback payments” would not be sufficient for consumers to evaluate the expected level of monetary incentives and remuneration. There may also be uncertainty in terms of the disclosure to the policyholder of the payments made directly or indirectly by them, and whether remuneration is paid out of these payments or not. In the latter case these could amount in some cases to hidden costs.

Rebating to policyholders monetary incentives and remuneration received is generally perceived by stakeholders as a good practice. Although from a legal perspective, the assets of unit-linked funds belong to the insurance undertaking, they have been purchased with money provided by policyholders and, therefore, **it could be argued that policyholders should**

be entitled to the economic benefits those assets generate in addition to investment income[89]. Arguably, any such benefits not provided to policyholders should be reflected appropriately in performance information as lost returns or "costs". However, rebating monetary incentives and remuneration received is not common practice.

Even if considered as an important element in promoting fairness, rebating could still undermine trust and create consumer confusion. Rebating may create the potential for consumer confusion as insurance undertakings may seek out remuneration-paying funds or remuneration-paying share classes and then rebate the commission to their customers as a marketing bonus. Although seemingly reducing fees, this may create confusion among customers about the true cost of both the product invested in and the services provided, depending on how the rebating is done, and how transparent the overall offer is.

Regarding how the assets of unit-linked funds are managed, **the lack of formal processes for the selection, monitoring and replacing of investment vehicles is a major source of potential consumer detriment in so far as it puts at risk the potential to use the most relevant or competitive underlying investment vehicles in the structuring of unit-linked funds**. Selecting the most relevant or competitive investment vehicles either in the effective structuring of unit-linked funds, or in case the insurance undertaking operates as a distributor of pooled funds managed by an in-house or external asset manager, **could be understood as part of the insurance undertaking's fiduciary duty and duty to act in the best interests of customers**. Insurance undertakings should, acting in the best interests of customers, also ensure that the appropriateness of their offer to policyholders is regularly assessed.

Delegating core processes to external parties (including asset managers of the investment vehicles themselves) or other entities within the group, or not, is clearly not a guarantee that these processes will be efficient or effective in ensuring that policyholders' interests are being safeguarded. Adequate **governance and oversight of these delegated responsibilities** and activities is a key element in adequately managing risk.

[89] Obtained from interest payments, dividends and capital gains.

Annex I – Methodology

Data sources

The analysis contained in this Report is based on data provide directly by NCAs and by insurance undertakings participating in the thematic review.

NCA data

NCA data consists mainly of quantitative market data covering elements such as the number of insurance undertakings operating in their respective jurisdictions, number of contracts, gross written premiums and assets under management. This data is, for the most part, reported in **Annex II**.

NCAs also reported on country-specific regulatory measures regarding monetary incentives and remuneration between providers of asset management services and insurance (e.g. provisions on disclosure and rebating) and on any voluntary industry-wide measures related to these practices. This information is relevant as regulatory measures and voluntary industry-wide measures may, to some extent, restrict, allow or provide guidance regarding these practices and, more generally, how insurance undertakings manage and mitigate potential conflicts of interest and act in the best interests of customers.

In addition, NCAs also provided aggregate data regarding the sample of participating insurance undertakings (e.g. market representativeness). NCA information was collected through questionnaires developed for the purpose of this thematic review.

Industry data

Data from the insurance undertakings participating in the thematic review was collected through a specific industry questionnaire. The industry questionnaire constituted the primary source of market information and combined tables, multiple choice questions and narrative questions to collect quantitative and qualitative information. The industry questionnaire covered issues such as: (i) the existence, magnitude and structuring of monetary incentives and remuneration, (ii) the structuring of asset management arrangements, (iii) the management of conflicts of interest, (iv) the processes for the selection of investment vehicles and asset managers and (v) the characteristics of unit-linked funds offered to policyholders. **Annex IV** presents a brief overview of the elements considered in the industry questionnaire.

EIOPA's Members circulated the questionnaire to selected insurance undertakings (life and composite insurance undertakings) operating in their jurisdiction. Considering the focus on conduct of business issues, each industry response covered one jurisdiction. For the purpose of the thematic review, each response was considered as a separate participating insurance undertaking. Participating insurance undertakings providing information for their operations in more than one jurisdiction completed the questionnaire for each jurisdiction separately[90]. The questionnaire referred to activities in 2015.

Market sampling

General principles applied to the selection of industry participants

Issuing the industry questionnaire to all insurance undertakings in every Member State would be extremely resource consuming and impractical for most markets. In view of this, it was decided that the industry questionnaire would be issued to a sample of insurance undertakings. The sample of participating insurance undertakings for each Member State was selected by the respective NCA (home supervisor).

To ensure that this approach did not have a limiting or diminishing effect on the representativeness of the information and subsequent findings and conclusions that could be drawn, the sample of participating insurance undertakings should be representative of each national market. Accordingly, in selecting which insurance undertakings to include in the sample, NCAs applied, to the extent possible, the following criteria:

- The sample should include insurance undertakings of different sizes;
- The sample should include insurance undertakings with different asset management arrangements, i.e.:
  - Directly manage assets;
  - Use of in-house asset managers;
  - Use of external asset managers;
- The sample should include:
  - 7 of the largest 10 insurance undertakings[91]:
    - Measured by gross written premiums in 2014[92];
    - Measure by assets under management at 31 December 2014[93];
  - 60% of the domestic unit-linked market measured by gross written premiums in 2014;
  - 60% of the domestic unit-linked market measured by assets under management at 31 December 2014.

The above criteria were understood as principle-based and its application depended on the structure of each national market (e.g. number of insurance

[90] In addition, insurance undertakings active in multiple Member States were not required to fill out the industry questionnaire for all jurisdictions but only for those jurisdictions selected by the NCA.

[91] Largest life insurance undertakings and composite insurance undertakings selling unit-linked products in each market.

[92] Gross written premiums for unit-linked business in each market.

[93] Assets under management for unit-linked business in each market.

undertakings, level of concentration and prevalence/existence of specific asset management arrangements).

Form of establishment

No restrictions were placed regarding the form of establishment of the insurance undertakings selected by NCAs or the jurisdiction(s) covered. NCAs were able to include in the sample any insurance undertakings taking-up business in their jurisdiction, as well as domestic insurance undertakings taking-up business in other jurisdictions.

Accordingly, the sample of participating insurance undertakings selected by NCAs could include, in principal, insurance undertakings taking-up business in the following forms:

- Insurance undertakings taking-up business in the home country;
- Insurance undertakings taking-up business in another Member State under the freedom of establishment[94];
- Insurance undertakings taking-up business in another Member State under the freedom to provide services[95].

Please note that suitable measures were taken to avoid duplication of responses for cross-border business, i.e., those situations where one insurance undertaking could be replying in relation to the same jurisdiction to both the home and the host supervisor.

Coordination between NCAs and EIOPA

EIOPA was responsible for the overall coordination of the thematic review, while NCAs were responsible for identifying participating insurance undertakings and gathering data from them. NCAs, as the contact point for participating insurance undertakings, were also responsible for handling clarification requests. EIOPA did not directly contact participating insurance undertakings[96].

Responses to the industry questionnaire were treated as confidential and in providing input to EIOPA, NCAs ensured that individual responses were anonymised[97]. No evidence which could identify individual insurance undertakings was disclosed.

[94] Insurance undertakings operating under the freedom of establishment are defined as branch offices of EU/EEA insurance undertakings and any permanent presence of an insurance undertaking even where that presence does not take the form of a branch, but consists, for example, of an office managed by the own staff of the insurance undertaking or by a person who is independent but has permanent authority to act for the insurance undertaking as an agency would.

[95] Insurance undertakings operating under the freedom to provide services include other forms of establishment not included in the above definition by which insurance undertakings or branches take-up business in other Member States.

[96] EIOPA received a single clarification request from a participating insurance undertaking. The participant was requested to contact the respective NCA.

[97] Each participating insurance undertaking had a unique participant code assigned by NCAs. The participant code included two letters and two digits. The two letters correspond to the NCA's country code and the two digits correspond to a sequential number to be assigned by NCAs.

Data treatment

Data validation

All data considered for the purpose of this thematic review was provide to EIOPA by NCAs. Market data directly provided by NCAs to EIOPA was subject to various consistency checks. However, a full validation of country-specific market data by EIOPA was not feasible due to unavailability of alternative data sources to validate direct data provided.

Data from participating insurance undertakings was primarily validated by NCAs. These included, for the most part, desk-based validations of quantitative input provided. No thorough checks were carried out regarding qualitative input, in particular for the narrative questions. No on-site inspections, meetings or interviews were carried out to collect data or to discuss the responses provided.

In addition to validations from NCAs, EIOPA carried out various consistency checks. Data inconsistencies were communicated to NCAs who, if deemed necessary, sought clarifications from participating insurance undertakings. Minor amendments were introduced without seeking validation from the participating insurance undertaking where it could be clearly established that the inconsistencies resulted from inputting data into the industry questionnaire rather than computing of the response (e.g. inserting the response in the adjacent cells, not providing total values where all partial values were provided).

Considering that industry responses provided by NCAs to EIOPA were anonymous, EIOPA was unable to use alternative sources of data to carry out a complete and exhaustive validation of quantitative data provide.

Q&A

Following the launch of the industry questionnaire, a set of Q&A was prepared by EIOPA to support NCAs in answering industry queries and clarification requests. The Q&A took inspiration from questions received by NCAs from participating insurance undertakings and shared with EIOPA. This set of Q&A was distributed to NCAs to ensure a prompt reply and consistency in responses across the different jurisdictions. Considering the anonymous character of the responses, NCAs were able to distribute the Q&A to industry, if deemed appropriate.

Despite this effort and informal industry contacts by NCAs, NCAs and EIOPA are not able to ascertain if all queries and questions were in effect sent to NCAs. The data collection process was also not fully immune to misinterpretations from participating insurance undertakings, although most misinterpretations would eventually be reflected in inconsistent responses which were addressed by EIOPA and the respective NCA.

Missing data and invalid responses

Participating insurance undertakings have generally provided comprehensive responses to the industry questionnaire.

However, not all respondents provided answers to every question of the industry questionnaire. While the vast majority of tables requesting quantitative data, yes/no questions and multiple questions were completed by all participants, the same was not true in the case of narrative questions where the number of participating insurance undertakings not providing answers to every single question was more significant.

Also, not all questions and sections were relevant to every participating insurance undertaking and were, accordingly, left blank. For example, insurance undertakings that did not receive or obtained some sort of monetary incentives and remuneration did not have to complete the questions regarding the structuring of monetary incentives and remuneration arrangements with asset managers.

Invalid responses to specific questions were omitted from the results. This does not, however, imply that the entire response from the participating insurance undertaking was disregarded; only the invalid answer. There were only a handful of cases where EIOPA and the respective NCA opted to fully disregard the response provided.

The approach described above implies that the results for each question consider the number of relevant and valid responses, not the entire sample in each question. To avoid misinterpretations, throughout the Report and where appropriate, results are provided in relative (percentage) rather than in absolute amounts.

Representativeness of the results

EIOPA is of the opinion that the quantitative and qualitative data obtained for the purpose of this thematic review is highly representative of the EU unit-linked market. Indeed, the significant market share of the participating insurance undertakings, the large amount of quantitative and qualitative data obtained and the generally high-quality level of responses allowed for the extraction of robust and meaningful results.

The negligible data issues encountered and their resolution has, in EIOPA’s opinion no impact in the EU-wide picture described in this Report.

Annex II – The European unit-linked market

The information presented in this section refers to 30 Member States[98]. All information, unless indicated otherwise, considers the business undertaken by domestic insurance undertakings[99]. It considers business carried out by domestic insurance undertakings in the home market and cross-border under the freedom of establishment or under the freedom to provide services.

It should be noted that the size of each national unit-linked market may be overestimated or underestimated, depending on the level of cross-border business carried out from or into the Member State. On the one hand, in addition to domestic insurance undertakings, foreign insurance undertakings also operate in some Member States under the freedom of establishment or the freedom to provide services principles. Likewise, domestic insurance undertakings may also operate cross-border under the freedom of establishment or the freedom to provide services principles but may have no domestic unit-linked business.

The information regarding foreign insurance undertakings operating in each Member State is not readily available from all NCAs. Foreign insurance undertakings wishing to underwrite unit-linked business under the freedom of establishment or the freedom to provide services have to notify the host supervisor that they intend to provide unit-linked business. However, in most cases, they do not have an obligation to inform the host NCA if they are *de facto* carrying out business in that market. Accordingly, NCAs tend to have, at most, the number of notifications received, not the number of foreign insurance undertakings operating in the market.

Information regarding cross-border operations of domestic insurance undertakings is reported to the home supervisor but the split by jurisdiction may not be readily available.

In any case, the approach to data collection does not hinder on the analysis carried out or main conclusions. Firstly, the consistent approach used throughout all Members States avoids double counting. Secondly, the thematic review has a broad EU-wide scope focusing on conduct of business issues rather than prudential elements. Finally, the level of EU-wide cross-border activity regarding unit-linked business is generally low. With some exceptions[100], it tends to generally occur between neighbouring Member States (e.g. Scandinavian countries, Baltic States) and into or from the largest markets.

[98] All EEA countries (**AT**, **BE**, **BG**, **CY**, **HR**, **CZ**, **DK**, **EE**, **ES**, **FI**, **FR**, **DE**, **GR**, **HU**, **IE**, **IT**, **LI**, **LV**, **LT**, **LU**, **MT**, **NL**, **NO**, **PL**, **PT**, **RO**, **SE**, **SI**, **SK** and **UK**), except **IS**. **IS** has opted not to participate in the thematic review on the basis of the diminished importance of the domestic unit-linked market. Data for **SE** refers only to insurance categorized as unit-linked insurance (*fondförsäkring*), excluding insurance categorized as depository insurance (*depåförsäkring*).

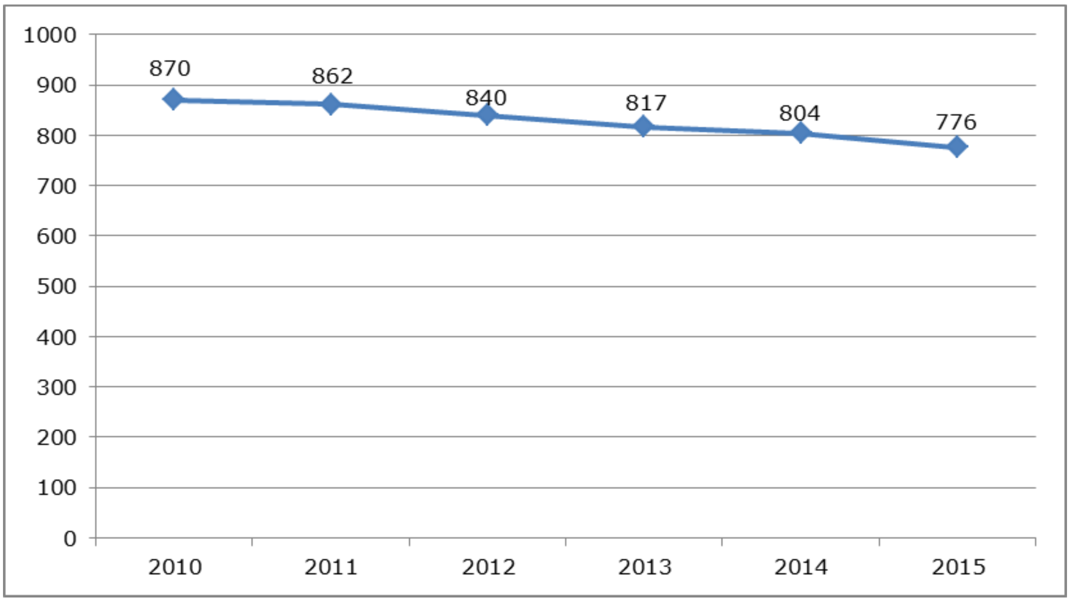
[99] Insurance undertakings with head office located in that Member State, subsidiaries of EU/EEA and non-EU/EEA country insurance undertakings and branches from insurance undertakings of non-EU/EEA countries.

[100] E.g. **IE**, **LI**, **LU** and **NL**.

Number of insurance undertakings

By end 2015 there were over 770 insurance undertakings (life or composite insurance undertakings) taking up unit-linked business. This number has been decreasing steadily since 2010 as seen in the next figure.

Figure 31: Number of insurance undertakings offering unit-linked insurance – 2010-2015[101]



The next table shows the number of insurance undertakings taking up unit-linked business, broken down by Member State. It considers the number of domestic insurance undertakings carrying out business in the respective domestic market and/or cross-border under the freedom of establishment or under the freedom to provide services.

[101] **ES** and **FR**: 2015 data used for all years as 2010-2014 data is not available; **NL** and **NO**: 2014 data used for 2015 as 2015 data is not available.

Table 1: Number of domestic insurance undertakings offering unit-linked insurance per Member State – 2015[102]

Country	Number of Insurance Undertakings
AT	22
BE	23
BG	7
CY	9
CZ	13
DE	79
DK	14
EE	4
ES	115
FI	9
FR	77
GR	14
HR	12
HU	16
IE	48
IT	48
LI	22
LT	5
LU	42
LV	2
MT	4
NL	30
NO	11
PL	23
PT	15
RO	13
SE	18
SI	10
SK	16
UK	55
Total	**776**

It should be noted that, overall, the above information may underestimate the number of insurance undertakings effectively operating in each Member State. Indeed, in addition to domestic insurance undertakings, foreign insurance undertakings also operate in some Member States under the freedom of establishment or the freedom to provide services principles. Nonetheless, it is

[102] **NL** and **NO**: Refers to 2014 as 2015 data is not available.

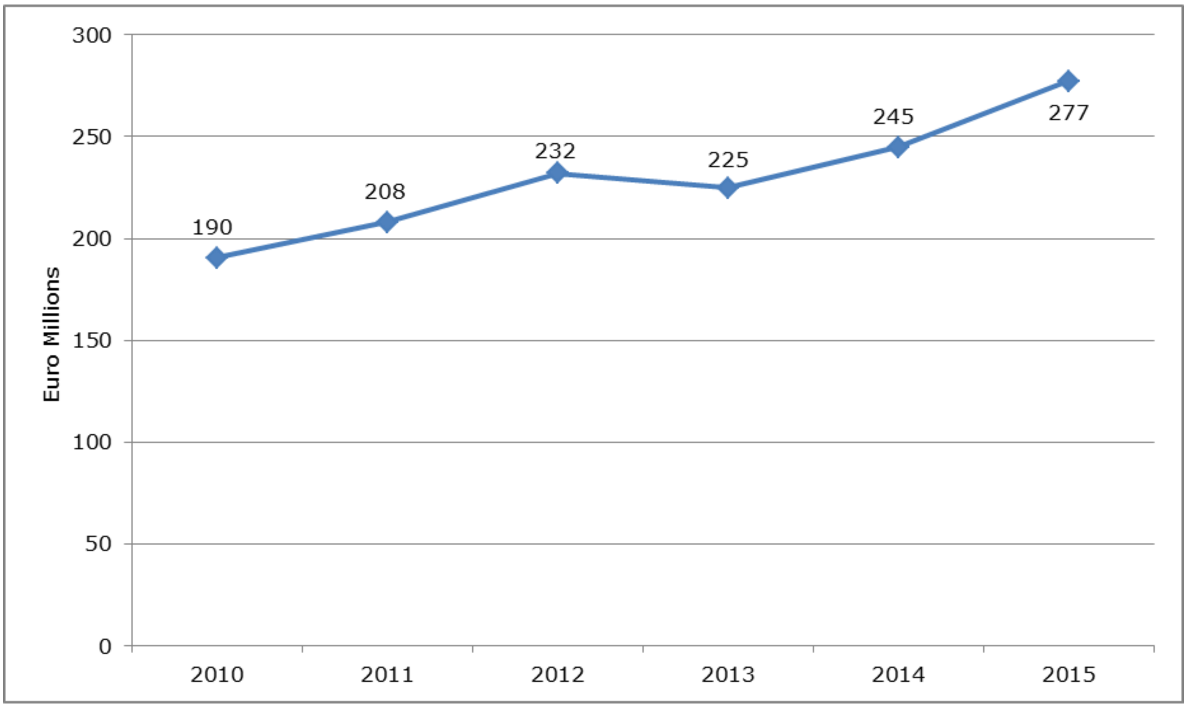
also the case that domestic insurance undertakings do not take up business in their domestic market and only carry out cross-border business in other Member States.

Although not all NCAs have data on cross-border business, available data indicates that, probably to no surprise, the number of foreign insurance undertakings operating under the freedom to provide services tends to be substantially higher than the number operating under the freedom of establishment, in several cases with a ratio of circa 30:1. The exception to this trend seems to be **NL** where the number of insurance undertakings operating under the freedom of establishment is significantly higher than the number operating under the freedom to provide services (142 vs 3).

Gross written premiums

The unit-linked industry has grown at a robust pace since 2010, with gross written premiums posting an average annual growth rate (2014-2015) of 8.0%.

Figure 32: Total value of GWP of unit-linked business – 2010-2015[103]



[103] **BG**, **ES** and **NO**: 2014 data used for 2015 as 2015 data is not available; **FI**, **FR** and **SE**: 2010 data is not available. **SE**: GWP of depository insurance (*depåförsäkring*) is excluded.

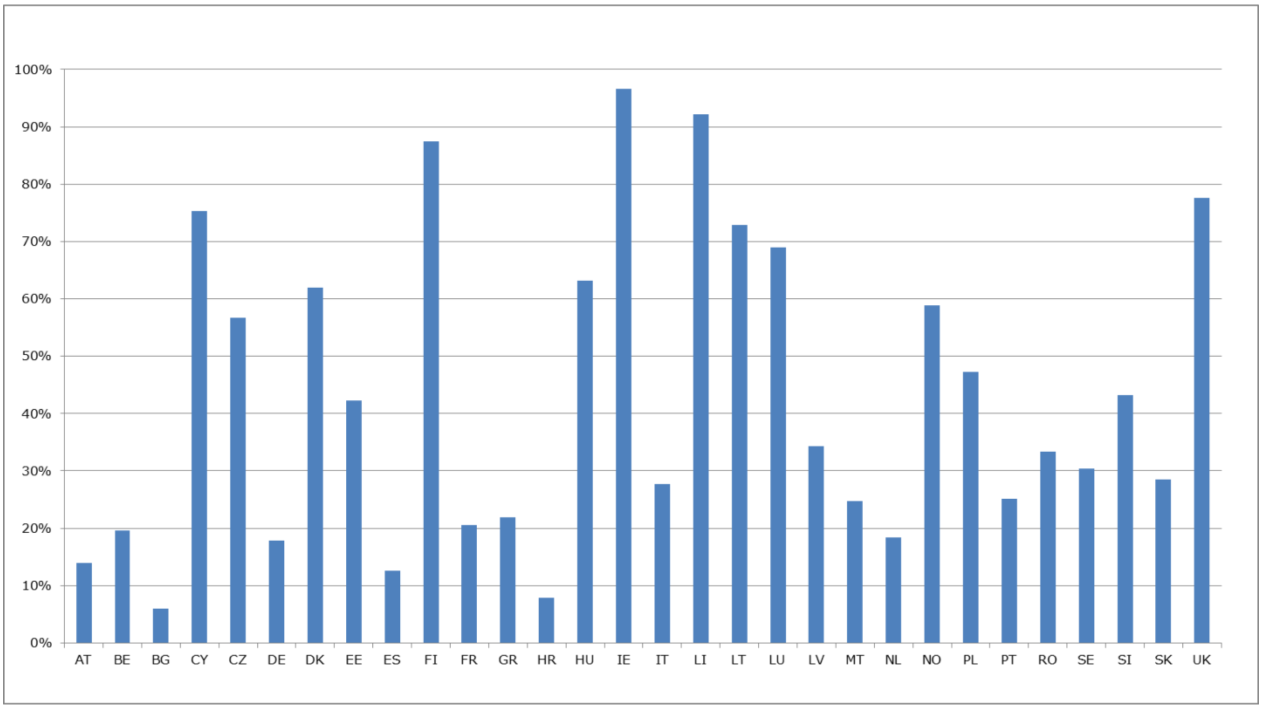
Table 2: Value of GWP of unit-linked business per Member State – 2015[104]

Country	GWP (EUR million)
AT	933
BE	2,979
BG	10
CY	213
CZ	1,169
DE	15,470
DK	12,272
EE	32
ES	2,816
FI	5,470
FR	28,900
GR	323
HR	30
HU	861
IE	31,565
IT	31,791
LI	59
LT	113
LU	14,679
LV	--
MT	89
NL	2,549
NO	594
PL	3,050
PT	2,114
RO	143
SE	6,565
SI	224
SK	300
UK	111,949
Total	**277,262**

[104] **BG**, **ES** and **NO**: refers to 2014 as 2015 data is not available; **LV**: Not disclosed at NCA's request for confidentiality reasons; **SE**: Figure excludes GWP of depository insurance (*depåförsäkring*).

With a total value of EUR 277m in 2015, unit-linked products accounted for a significant share of total life insurance premiums. This is particularly noticeable in some Member States, as shown in the next figure.

Figure 33: GWP of unit-linked business as percentage of total life insurance GWP per Member State – 2015[105]



Several demand-side and supply-side factors help explain the overall trend in the unit-linked market. The increase in demand seems to have been positively affected by a recovering equity market in 2014 as consumers, in search of yield, opted for products which typically offer the possibility to obtain higher returns (at a higher risk) when compared, for instance, to guaranteed products. In addition, in a context of low interest rates, the unit-linked market benefitted from new business as a result of the low deposit rates offered by the banking sector. The unit-linked market has also been supported by the phasing out of traditional insurance products and the switching from life insurance guaranteed policies to policies without or with lower guarantees, including unit-linked products.

In addition to country-specific issues, several factors may be pointed out as limiting the growth of the unit-linked market. Firstly, consumers may still need to regain trust in these products and similar investment products in the aftermath of the capital-market crash and, in a prolonged unstable financial and economic climate[106], may still be unwilling to take on additional financial risks.

Despite the overall growth in the unit-linked market, this trend differed significantly among Member States as can be seen from the table below.

[105] **BG**, **ES** and **NO**: Refers to 2014 as 2015 data is not available. **SE**: GWP of depository insurance (*depåförsäkring*) is excluded.

[106] This factor may also help to explain the relatively high level of surrenders for unit-linked products in some Member States.

Table 3: Compound annual growth rate of GWP of unit-linked business per Member State – 2010-2015[107]

Country	Compound Annual Growth Rate GWP (percentage)
AT	-7.6%
BE	7.8%
BG	2.3%
CY	-5.3%
CZ	-0.4%
DE	3.6%
DK	20.6%
EE	-4.2%
ES	-10.0%
FI	18.8%
FR	13.5%
GR	2.7%
HR	5.8%
HU	-4.1%
IE	8.4%
IT	20.8%
LI	16.9%
LT	11.4%
LU	-0.3%
LV	11.8%
MT	21.5%
NL	-12.3%
NO	7.1%
PL	8.3%
PT	-0.5%
RO	-1.3%
SE	1.4%
SI	-1.8%
SK	-1.0%
UK	1.7%

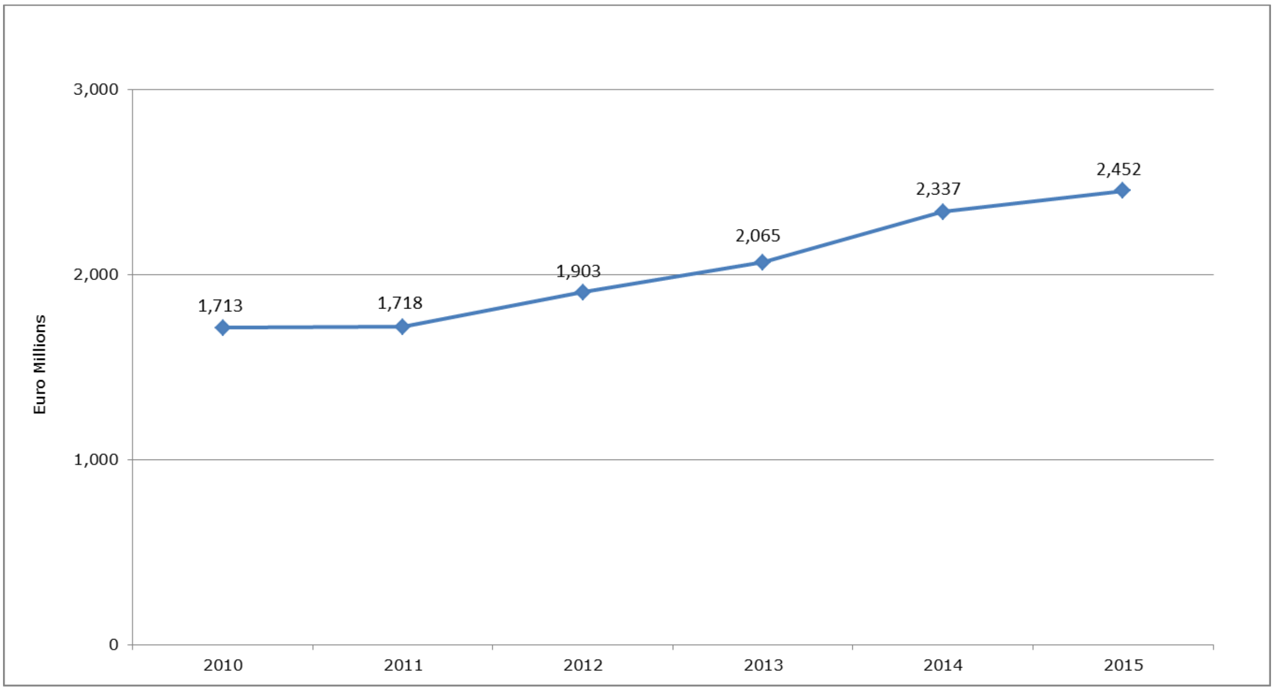
Some Member States experienced significant decreases in the level of annual gross written premiums from 2010 to 2015. Overall, the increase in gross written premiums seems to be influenced by the growth experienced by the largest markets.

[107] **BG**, **ES** and **NO**: 2014 data used for 2015 as 2015 data is not available; **FI, FR** and **SE**: Refers to 2011-2015 as 2010 data is not available. **SE**: GWP of depository insurance (*depåförsäkring*) is excluded.

Assets under management

The importance of the unit-linked market for the economy is also reflected in the large amount of assets held in unit-linked contracts. Total assets allocated to unit-linked contracts amounted to EUR 2,26bn in 2015.

Figure 34: Total value of AUM of unit-linked business – 2010-2015[108]



[108] **BG**, **ES** and **NO**: 2014 data used for 2015 as 2015 data is not available; **ES**: 2010-2013 data is not available; **FI**: 2010 data is not available; **MT**: 2010-2015 data is not available. **SE**: AUM of depository insurance (*depåförsäkring*) is excluded.

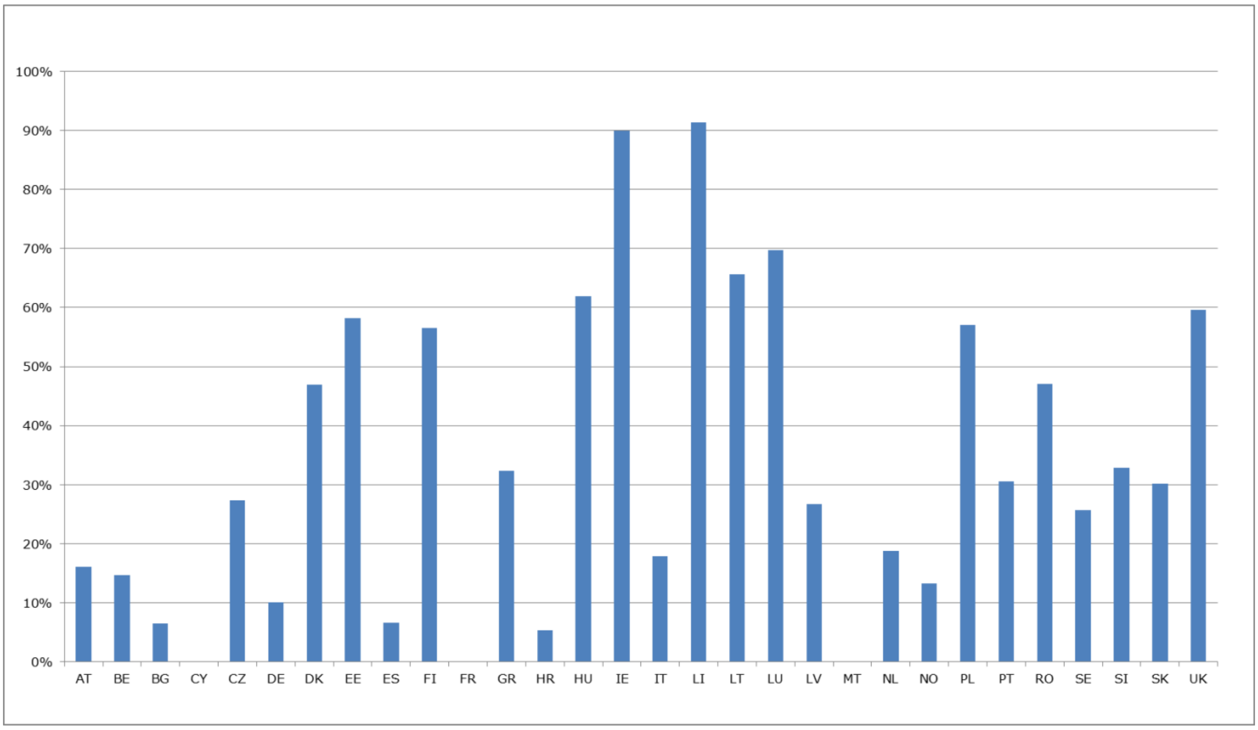
Table 4: Value of AUM of unit-linked business per Member State – 2015[109]

Country	AUM (EUR million)
AT	11,970
BE	29,812
BG	46
CY	1,843
CZ	2,439
DE	95,063
DK	114,807
EE	566
ES	15,300
FI	31,633
FR	289,700
GR	2,114
HR	122
HU	3,428
IE	190,465
IT	102,624
LI	32
LT	407
LU	106,118
LV	--
MT	N/A
NL	55,071
NO	17,684
PL	13,010
PT	12,748
RO	774
SE	96,008
SI	1,222
SK	1,144
UK	1,255,553
Total	**2,451,704**

Assets held in unit-linked products accounted for a significant share of total assets held by life insurance undertakings. This is particularly noticeable in some Member States, as shown in the next figure.

[109] **BG**, **ES** and **NO**: refers to 2014 as 2015 data is not available; **IE**: includes some business that is not "pure" unit linked business such as variable annuities; **LV**: Not disclosed at NCA's request for confidentiality reasons; **SE:** Figure excludes AUM of depository insurance (*depåförsäkring*).

Figure 35: AUM of unit-linked business as percentage of total life insurance AUM per Member State – 2015[110]



110 **BG**, **ES** and **NO**: Refers to 2014 as 2015 data is not available; **MT**: Domestic unit-linked data is not available; **CY**, **FR** and **MT**: Total life insurance data is not available. **SE**: AUM of depository insurance (*depåförsäkring*) is excluded.

Table 5: Compound annual growth rate of AUM of unit-linked business per Member State – 2010-2015[111]

Country	Compound Annual Growth Rate AUM (percentage)
AT	4.9%
BE	9.4%
BG	6.5%
CY	-2.6%
CZ	6.6%
DE	11.2%
DK	27.0%
EE	7.0%
ES	N/A
FI	23.7%
FR	5.4%
GR	0.3%
HR	7.4%
HU	0.0%
IE	7.2%
IT	11.0%
LI	-1.2%
LT	14.0%
LU	9.1%
LV	12.2%
MT	N/A
NL	-1.8%
NO	12.6%
PL	5.8%
PT	-5.2%
RO	11.7%
SE	14.5%
SI	7.4%
SK	5.5%
UK	5.8%

[111] **BG** and **NO**: 2014 data used for 2015 as 2015 data is not available; **ES**: Only 2014 data is available, no data range; **FI**: 2010 data is not available, data reference range is 2011-2015; **MT**: 2010-2015 data is not available; **SE**: AUM of depository insurance (*depåförsäkring*) is excluded.

Annex III – Participating insurance undertakings

218 responses to the industry questionnaire were considered in the thematic review[112].

Responses were received from 28 Member States. **IS** did not participate in the thematic review considering the small importance of the unit-linked business in its jurisdiction. **CY** and **NO**, although having provided market data to EIOPA (reported in **Annex II**), have decided not to issue the industry questionnaire to insurance undertakings. In the case of **NO**, Finanstilsynet carried out a market survey in 2014 looking into remuneration received from asset managers. The main results were shared with EIOPA but are not considered in this Report.

Note that the reported values regarding the number of participants, gross written premiums and assets under management are in reference to the participating insurance undertakings reported by the NCA of each Member State, not the number of responses with reference to each jurisdiction.

Note that the reference date for the figures regarding the participating insurance undertakings is the year 2014. This is different to the reference date of the individual insurance undertaking responses to the industry questionnaire (2015).

Considering that the sample consists mostly of domestic insurance undertakings operating in the home market, this allocation of responses per Member State is not considered problematic and, most importantly, does not impact on overall results of the thematic review, taking into account its EU-wide perspective. For Member States[113] that have opted to include undertakings doing cross-border business, the statistics should be interpreted bearing this in mind.

[112] The number of insurance undertakings taking part in the thematic review was 222. However EIOPA and the respective NCA chose to disregard some responses due to significant inconsistencies found during the validation process.

[113] **LT** and **LU**: Domestic insurance undertakings operating in another Member State under the freedom of establishment; **IE** and **LU**: Domestic insurance undertakings operating in another Member State under the freedom to provide services; **CZ**, **FR** and **SK**: Foreign insurance undertakings operating in their jurisdiction under the freedom of establishment; **HU**: Foreign insurance undertakings operating in their jurisdiction under the freedom to provide services. Data for **SE** refers only to insurance categorized as unit-linked insurance (*fondförsäkring*), excluding insurance categorized as depository insurance (*depåförsäkring*).

Number of participating insurance undertakings

The next table shows the number of participating insurance undertakings reported per NCA of each Member State.

Table 6: Number of participants reported per Member State

Country	Number of Participants
AT	7
BE	10
BG	4
CZ	16
DE	9
DK	10
EE	4
ES	7
FI	3
FR	10
GR	7
HR	7
HU	15
IE	7
IT	8
LI	7
LT	6
LU	8
LV	2
MT	4
NL	7
PL	7
PT	7
RO	5
SE	8
SI	7
SK	16
UK	10
Total	**218**

Number of participating insurance undertakings per form of establishment

Considering the principles set out for the composition of the national samples and the prevailing market structures, the sample consists mostly of domestic insurance undertakings operating in the home market as shown in the table below.

Table 7: Number of participants by form of establishment

Number of participants by form of establishment[114]	Total
Domestic insurance undertakings operating in the home country	184
Domestic insurance undertakings operating in another Member State under FoE	2
Domestic insurance undertakings operating in another Member State under FoS	10
Foreign insurance undertakings operating in the NCA's market under the FoE	8
Foreign insurance undertakings operating in the NCA's market under FoS	14
Total	**218**

The majority of Member States[115] have opted to only include in the sample domestic insurance undertakings taking-up business in the home country while only 7 Member States[116] have opted to include undertakings doing cross-border business.

[114] In reference to reporting NCA.

[115] **AT**, **BE**, **BG**, **HR**, **DK**, **EE**, **ES**, **FI**, **DE**, **GR**, **IT**, **LI**, **LV**, **MT**, **NL**, **PL**, **PT**, **RO**, **SE**, **SI** and **UK**.

[116] **CZ**, **FR**, **HU**, **IE**, **LT**, **LU** and **SK**.

Gross written premiums

The table below shows the volume of gross written premiums in 2014 for the participating insurance undertakings reported by each NCA.

Table 8: GWP of participants reported per Member State - 2014[117]

Country	GWP (EUR million)
AT	680
BE	2,346
BG	7
CZ	1,343
DE	8,928
DK	10,164
EE	17
ES	2,721
FI	5,078
FR	16,738
GR	373
HR	17
HU	1,451
IE	5,392
IT	15,952
LI	28
LT	97
LU	3,084
LV	--
MT	40
NL	1,723
PL	1,987
PT	2,031
RO	109
SE	4,478
SI	126
SK	399
UK	79,528
Total	**164,835**

[117] **LV**: Not disclosed at NCA's request for confidentiality reasons.

Assets under management

The table below shows the volume of assets under management at 31 December 2014 for the participating insurance undertakings reported by each NCA.

Table 9: AUM of participants reported per Member State - 2014[118]

Country	AUM (EUR million)
AT	10,844
BE	26,539
BG	N/A
CZ	2,934
DE	63,177
DK	95,001
EE	221
ES	15,480
FI	23,873
FR	177,682.51
GR	1,840
HR	57
HU	5,683
IE	170,422
IT	69,784
LI	34
LT	336
LU	23,659
LV	--
MT	316
NL	38,044
PL	9,257
PT	13,252
RO	699
SE	61,003
SI	746
SK	1,325
UK	839,812
Total	**1,652,018**

[118] **BG**: Data is not available; **LV**: Not disclosed at NCA's request for confidentiality reasons.

Market representativeness of participants per Member States

Market share

The high level of participation and representativeness of the sample may also be inferred from the table below which shows, for each Member State, the market share of the selected sample measured by gross written premiums in 2014 and assets under management at 31 December 2014 in reference to the domestic unit-linked market[119].

Table 10: Market share of participants per Member State measured by GWP and AUM of domestic market - 2014[120]

Country	Market share of sample	
	as % of GWP	as % of AUM
AT	74%	90%
BE	94%	95%
BG	77%	N/A
CZ	100%	100%
DE	60%	67%
DK	92%	96%
EE	100%	100%
ES	71%	39%
FI	83%	88%
FR	77%	67%
GR	94%	83%
HR	95%	49%
HU	100%	100%
IE	82%	72%
IT	73%	73%
LI	98%	97%
LT	64%	61%
LU	25%	24%
LV	32%	N/A
MT	100%	100%
NL	89%	88%
PL	67%	73%

[119] Domestic insurance undertakings operating in domestic market and foreign insurance undertakings operating in domestic market under the freedom of establishment or under the freedom to provide services.

[120] **BG**: AUM data is not available; **IE**: includes outgoing business on an FoE/FoS basis; **LV**: Data is not available for market share as percentage of AUM.

Country	Market share of sample	
PT	95%	94%
RO	88%	97%
SE	71%	64%
SI	61%	63%
SK	99%	98%
UK	76%	68%

Please note that as the market share is measured in relation to the domestic unit-linked market, the market share of Member States that have included in the sample domestic insurance undertakings operating in another Member State either under the freedom of establishment or the freedom to provide services may appear to be under-estimated. This is the case for **IE**, **LT** but especially **LU** where 7 of the 8 participants are insurance undertakings operating in another Member State.

Inclusion of largest insurance undertakings

Although each national sample should preferably include insurance undertakings of different sizes, the participation of the largest insurance undertakings by Member State is focal to draw meaningful and robust conclusions that may be generalized to the whole unit-linked market. The figures below assess this, displaying, per Member State, the number of participating insurance undertakings in the top 5 and top 10 measured by gross written premiums in 2014 and assets under management at 31 December 2014.

Figure 36: Number of participants in top 5 and top 10 of domestic market measured by GWP[121]

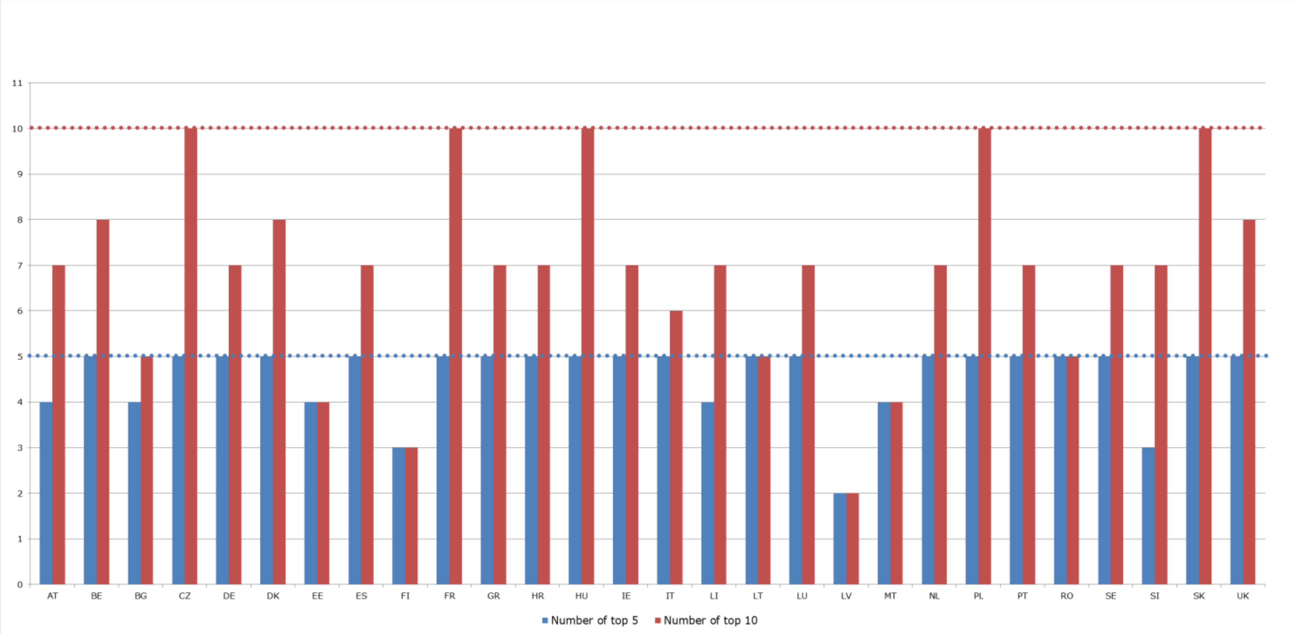
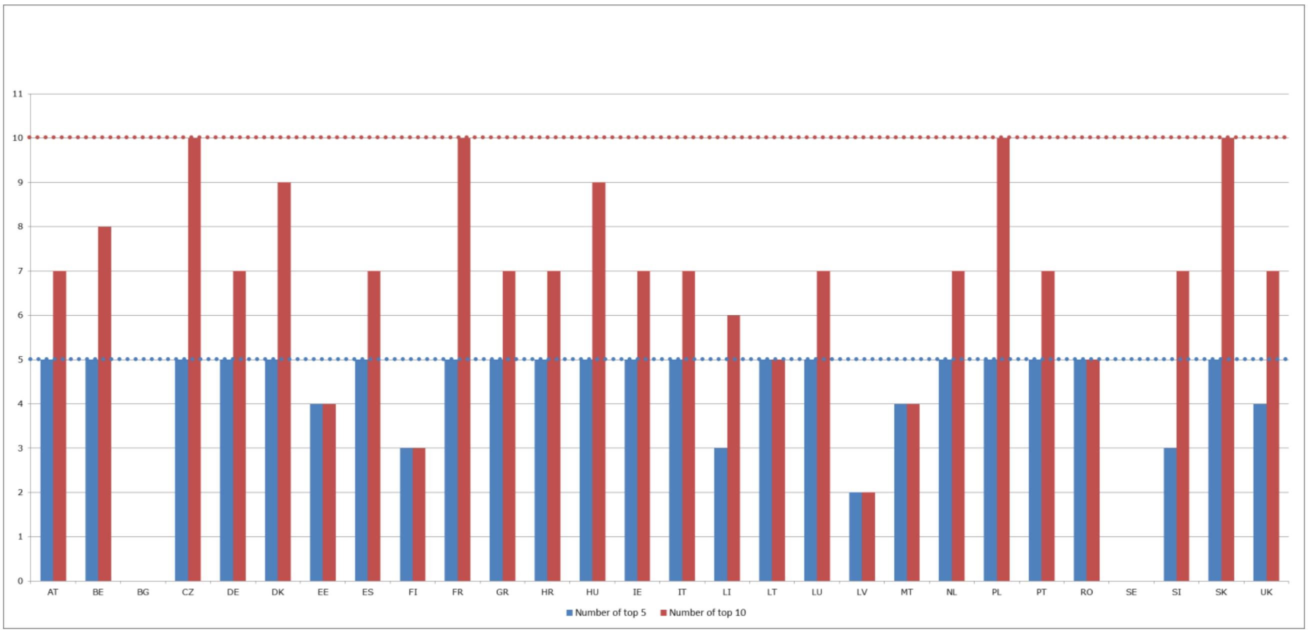


Figure 37: Number of participants in top 5 and top 10 of domestic market measured by AUM[122]



Please note that the above figure may be misleading for those Member States where the sample represents 100% of the market but have no more than 5 undertakings operating in the domestic market. This is the case for **EE** and **MT**.

121 **IE**: domestic market includes outgoing business on an FoE/FoS basis.

122 **BG** and **SE**: Data is not available; **IE**: domestic market includes outgoing business on an FoE/FoS basis.

Also, in the case of **LU**, the largest domestic undertakings were included in the sample but completed the industry questionnaire for their main market, not necessarily the domestic market.

Market representativeness of each Member State's sample

The table below shows the market representativeness of the participants of each Member State measured by the number of participants, the share of gross written premiums in 2014 and the share of assets under management at 31 December 2014.

Table 11: Market representativeness of each Member State's sample

Country	% of Participants	% of GWP	% of AUM
AT	3.2%	0.36%	0.66%
BE	4.6%	1.23%	1.61%
BG	1.8%	<0.01%	N/A
CZ	7.3%	0.71%	0.18%
DE	4.1%	4.69%	3.82%
DK	4.6%	5.34%	5.75%
EE	1.8%	0.01%	0.01%
ES	3.2%	1.43%	0.94%
FI	1.4%	2.67%	1.45%
FR	4.6%	8.79%	10.76%
GR	3.2%	0.20%	0.11%
HR	3.2%	0.01%	<0.01%
HU	6.9%	0.76%	0.34%
IE	3.2%	2.83%	10.32%
IT	3.7%	8.38%	4.22%
LI	3.2%	0.01%	<0.01%
LT	2.8%	0.05%	0.02%
LU	3.7%	1.62%	1.43%
LV	0.9%	0.01%	<0.01%
MT	1.8%	0.02%	0.02%
NL	3.2%	0.91%	2.30%
PL	3.2%	1.04%	0.56%
PT	3.2%	1.07%	0.80%
RO	2.3%	0.06%	0.04%
SE	3.7%	2.35%	3.69%
SI	3.2%	0.07%	0.05%
SK	7.3%	0.21%	0.07%
UK	4.6%	55.19%	50.84%

Annex IV – Overview of industry questionnaire

Existence of monetary incentives and remuneration

Considers:

- Monetary incentives and remuneration from asset managers;
- Types of monetary incentives and remuneration (recurring, one-off or other types of monetary incentives and remuneration);
- Types of non-monetary benefits;
- Monetary incentives and remuneration from third parties;
- Types of funds to which monetary incentives and remuneration apply.

Magnitude of monetary incentives and remuneration

Considers:

- Absolute value of monetary incentives and remuneration split by:
    - Type of monetary incentives and remuneration;
    - Type of asset manager (in-house or external asset manager);
- Relative value of monetary incentives and remuneration in relation to:
    - Assets of unit-linked funds;
    - Fund management charges.

Structuring of monetary incentives and remuneration

Considers:

- Existence of contractual agreements between parties;
- Main features of contractual agreements;
- How monetary incentives and remuneration vary, if at all, by:
    - Type of asset manager (in-house or external asset manager);
    - Type of investment vehicle (pooled fund or segregated portfolio)
    - Type of investment mandate;
- How and when monetary incentives and remuneration are received.

Structuring of asset management arrangements

- Assets of unit-linked funds by:
    - Type of asset manager (in-house or external asset manager);
    - Type of investment vehicle (pooled fund or segregated portfolio);
    - Type of investment strategy (passive or active);

- Number of asset managers used by type (in-house or external asset manager);
- Number of investment vehicles used by type (pooled fund or segregated portfolio) and by type of investment strategy (passive or active);
- Concentration level for largest asset managers used;
- Classification of investment vehicles according to asset class (equity, bond, multi-asset, money market, absolute return, other).

Addressing conflicts of interest

Considers:

- How insurance undertakings manage and mitigate conflicts and act in the best interests of customers;
- Disclosure of monetary incentives and remuneration practices;
- How monetary incentives and remuneration received are passed on to policyholders.

Selection of investment vehicles/asset managers

Considers:

- Elements taken into consideration when selecting asset managers;
- Processes for selecting, monitoring and replacing investment vehicles.

Characteristics of unit-linked funds offered

Considers:

- Number of unit-linked funds offered by:
  - Type of asset management arrangement;
  - Type of investment strategy (passive or active);
  - Type of asset class (equity, bond, multi-asset, money market, absolute return, other).

Characteristics of investment vehicles used as underlying assets

More granular data was collected for the largest investment vehicles[123] used by each participating insurance undertaking in the management of assets of unit-linked funds.

The information collected included, for each underlying investment vehicle, the following:

- Market value of holding;

[123] Upper quartile of investment vehicles used by each participating insurance undertaking, up to a maximum of 10 investment vehicles, measured by the market value of holdings at 31 December 2015.

- Type of investment vehicle (pooled fund or segregated portfolio);
- Type of asset manager (in-house or external asset manager);
- Asset class (equity, bond, multi-asset, money market, absolute return, other);
- Type of investment strategy (active or passive);
- Holding period (period of time since the insurance undertaking has held the investment vehicle);
- Number of underperforming quarters (number of underperforming quarters during the last three years – period 2013-2015 – against benchmark or target return specified in formal investment vehicle's documents such as prospectus, statement of investment principles or mandate indicating the investment objective/policy);
- Value of monetary remuneration received during 2015.

Annex V – Fund classification

The European Fund Classification (EFC) is a pan-European classification system of investment funds which has been developed by the European Fund Categorization Forum (EFCF) – a working group of the European Fund and Asset Management Association (EFAMA). Below, a summary description of each asset class considered is provided[124].

Equity fund

Fund that invests at least 85% of its assets in equities.

Bond fund

Fund that invests at least 80% of its assets in fixed income securities. Investment in cash does not exceed 20%; investment in convertibles does not exceed 20%; investment in asset backed/mortgage-backed securities does not exceed 20%; investment in other assets does not exceed 10% and is limited to ensure that the 80% minimum investment in fixed income securities is always respected; no equity exposure.

Multi-asset fund

Fund that invests in a combination of asset classes including variable income securities, debt securities, cash and cash equivalents, real estate securities and commodity securities.

Money market fund

Fund that invests in short-term debt securities, cash-equivalent assets, money market instruments of high quality or deposits with credit institutions; no direct or indirect exposure to equity or commodities, including via derivatives.

Absolute return fund

Fund that is managed with the objective of generating a positive return over a cash benchmark, irrespective of market movements. There are no restrictions to the fund's holdings.

Other

Fund that falls outside the above broad categories. Also includes property funds, i.e., funds that invest the majority of its assets in real estate including commercial and residential property, land, real estate developments and other

[124] For more information please refer to The European Fund Classification – EFC Categories available at http://www.efama.org/Publications/Public/European_Fund_Classification/EFC%20Categories%20Report.pdf.

forms of property investments and property-linked securities, either directly or through shares in property companies or other property funds.

Annex VI – Table of figures

Annex VII – Table of tables

Annex VIII – List of abbreviations

Abbreviation	Term
AIF	Alternative Investment Fund
AIFMD	Alternative Investment Fund Managers Directive
AUM	Assets Under Management
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
EU	European Union
FMC	Fund Management Charges
FoE	Freedom of Establishment
FoS	Freedom to Provide Services
IDD	Insurance Distribution Directive
GWP	Gross Written Premiums
PRIIPs	Packaged Retail and Insurance-based Investment Products
MiFID	Markets in Financial Instruments Directive
NCA	National Competent Authority
UCITS	Undertakings for the Collective Investment in Transferable Securities

The monetary units used are out in the below table.

Abbreviation	Unit
m	Million - 10^6
bn	Billion - 10^9
tn	Trillion 10^{12}

Note: A period has been used to indicate the decimal place and a comma to separate groups of thousands.

The country codes of EEA Member States are set out in the below table.

Code	Member State
AT	Austria
BE	Belgium
BG	Bulgaria
CY	Cyprus
CZ	Czech Republic
DE	Germany
DK	Denmark
EE	Estonia
ES	Spain
FI	Finland
FR	France
GR	Greece
HR	Croatia
HU	Hungary
IE	Ireland
IS	Iceland
IT	Italy
LI	Liechtenstein
LT	Lithuania
LU	Luxembourg
LV	Latvia
MT	Malta
NL	Netherlands
NO	Norway
PL	Poland
PT	Portugal
RO	Romania
SE	Sweden
SI	Slovenia
SK	Slovakia
UK	United Kingdom

Annex IX – Glossary

Asset management arrangement – directly managed assets

Arrangement whereby the insurance undertaking takes investment decisions regarding which specific securities (e.g. bonds, equities) to hold, to buy or to sell and directly holds these in the portfolio. Note that insurance undertakings may use a combination of arrangements for the same unit-linked fund.

Asset management arrangement – indirectly managed assets

Arrangement whereby a third party, not the insurance undertaking, takes the investment decisions regarding which securities to hold, to buy or sell. Under this type of arrangement the third party may be an in-house asset manager or an external asset manager and the insurance undertaking may use an existing pooled fund (e.g. UCITS or AIF) or a segregated portfolio as the investment vehicle. Note that insurance undertakings may use a combination of arrangements for the same unit-linked fund.

Asset manager – external asset manager

An asset management company that is not part of the same group as the insurance undertaking, i.e., an asset management company not owned or controlled by the insurance undertaking or vice-versa nor owned or controlled by the same holding company that owns or controls the insurance undertaking. Does not refer to an individual or employee of an investment firm whose professional activity is to manage a portfolio of assets.

Asset manager – in-house asset manager

An asset management company that is part of the same group as the insurance undertaking, i.e., an asset management company owned or controlled by the insurance undertaking or vice-versa or an asset management company that is owned or controlled by the same holding company that owns or controls the insurance undertaking. Does not refer to an individual or employee of an investment firm or insurance undertaking whose professional activity is to manage a portfolio of assets.

Beauty parade

Formal presentation given to the insurance undertaking by asset managers in response to a tender.

Box management

Situation whereby the insurance undertaking holds additional units in excess of those allocated to policyholders allowing for units to be bought and sold on an almost instant basis while the insurance undertaking has time to adjust the underlying portfolio to match the overall unit investment base. The insurance undertaking may profit through strategic management of the units it holds if it is able to exploit information at its disposal and benefit if the value of the units rises.

Discounts on fund management charges

Reduction in the quoted fund management charges offered to the insurance undertaking by the asset manager. The lower charge may take the form of a rebate (where the asset manager continues to charge the quoted ongoing charge of the investment vehicle but gives back a discount to the insurance undertaking at regular intervals) or a built-in reduction on the fund management charges.

Fund management charges

Fee or charge levied by an asset manager to cover for investment and portfolio management services, normally deducted from the fund value where such deductions are required or permitted by national law and regulation. Excludes other ongoing costs associated with the day-to-day management of investments such as dealing costs or transaction commissions, depositary/custody fees, taxes and ongoing costs that may be charged on an annual basis such as auditor fees. Excludes performance-related fees. Excludes one-off costs such as entry costs (e.g. subscription fees) or exit costs (e.g. penalty fees).

Group of companies

Set of companies that share a holding company or subsidiary relationship and that function as a single economic entity through a common source of control by virtue of shareholding or directorship.

Insurance undertaking – domestic insurance undertakings

Insurance undertaking with primary corporate headquarters located in that Member State, subsidiaries of EU/EEA and non-EU/EEA country insurance undertakings and branches from insurance undertakings of non-EU/EEA countries.

Insurance undertaking – operating under the freedom of establishment

Branch offices of EU/EEA insurance undertakings and any permanent presence of an insurance undertaking even where that presence does not take the form of a branch, but consists, for example, of an office managed by the own staff of the insurance undertaking or by a person who is independent but has permanent authority to act for the insurance undertaking as an agency would.

Insurance undertaking – operating under the freedom to provide services

Include other forms of establishment not included in the above definitions by which insurance undertakings or branches take-up business in other Member States.

Insurance with profit participation

Long-term insurance contract which provides benefits through, at least in part, eligibility to participate materially in periodic discretionary distributions based on profits arising from the insurance undertaking's business or from a particular part.

Investment strategy – active investment strategy

Approach to investment management that aims to outperform a particular market index or benchmark through asset allocation and/or selection decisions.

Investment strategy – passive investment strategy

Approach to investment management that aims to replicate a particular market index or benchmark and does not attempt to actively manage the portfolio.

Investment vehicle – pooled fund

Investment vehicle in which a number of investors pool their assets which are managed on a collective basis; collective investment scheme such as an UCITS (Undertakings for Collective Investment in Transferable Securities) or AIF (Alternative Investment Fund).

Investment vehicle – segregated portfolio

Investment portfolio which is managed on behalf of a single client according to a specific investment mandate and with separately identifiable assets.

Mirror fund/external fund links

Unit-linked fund that invests in a single re-insured unit-linked fund or single collective investment scheme managed by an in-house or external asset manager. As the name implies, mirror funds "mirror" the performance of the underlying fund that they invest in, although the returns may differ between both funds due to differences in charges, cash management, taxation and timing of investing.

Own funds (of insurance undertaking)

Assets of the insurance undertaking free of any foreseeable liabilities.

Request for information (RfI)

Business process to collect written information about the capabilities of various asset managers. It normally indicates the service requirements of the insurance undertaking and follows a format that can be used for comparative purposes and to narrow down a list of potential service providers.

Request for proposal (RfP)

Business process used in the selection of asset managers to obtain bids from normally a restricted number of asset managers in a competitive process. It provides details on the investment services the insurance undertaking is seeking, outlines the bidding process, contractual terms and provides guidance on how the bid should be formatted and presented.

Seeding of unit-linked funds

Initial capital of a unit-linked fund at inception. The size of initial seeding should be considered by insurance undertakings when launching a new fund to ensure that the fund is of sufficient size to effectively follow its investment mandate, to reduce operational risk if the fund expands quickly and to ensure an acceptable initial total expense ratio.

Stock-lending

Security transaction whereby an insurance undertaking lends for a limited period of time a security to a third party investor or firm, thus passing on legal ownership and receiving in return collateral and a fee for the use of the loaned security.

Type/group of policyholder

Subset of policyholders who can be grouped together or categorized according to a common characteristic such as type of contract held (e.g. unit-linked contract without guarantees vs. unit-linked contract with guarantees), individual vs. group insurance, purpose of unit-linked contract (investment purpose vs. financing for retirement), demographics, value of insurance contract, retail vs. wholesale customer, etc.

Unit-linked contract with guarantees

Unit-linked life insurance contract with an investment guarantee which sets forth guarantees regarding the price of the unit or the value of the contract. Examples of such guarantees include: capital guarantee (e.g. the price of the unit will never go down), minimum return guarantee (the price of the unit is guaranteed to increase by at least a pre-determined percentage each year) and guaranteed payouts (e.g. minimum guaranteed maturity benefits, minimum withdrawal value, etc.). The guarantee is set at the level of the contract and underlying assets may or may not have an investment guarantee. The price of the unit may or may not be directly linked to the investment performance of the underlying assets.

Unit-linked contract without guarantees

Unit-linked life insurance contract with no guarantee on either the price of the unit or the value of the contract. The benefits are determined based on the value of units which is directly linked to the investment performance of the underlying assets. Underlying assets may have investment guarantees but, if existing, these are not reflected at the level of the contract.

Unit-linked fund

In relation to an insurance contract classified as a unit-linked life insurance contract, a pooled investment vehicle operated by an insurance undertaking where the value of an investor's holding in the fund is represented by the number of units held multiplied by the unit price.