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Opinion of the European Insurance and Occupational Pensions Authority on the proposed product intervention measure of Komisja Nadzoru Finansowego of Poland

1. Introduction and legal basis

- 1.1 The European Insurance and Occupational Pensions Authority (EIOPA) provides this Opinion on the basis of Article 18(2) of Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).¹
- 1.2 Article 17 of Regulation (EU) No 1286/2014 empowers competent authorities to prohibit or restrict in or from their Member States the marketing, distribution or sale of insurance-based investment products (IBIPs) or IBIPs with certain specific features or a type of financial activity or practice of an insurance or reinsurance undertaking. This power is subject to the fulfilment of the conditions defined in Article 17(2) of that Regulation and to the assessment of the relevant factors and criteria listed in Article 2(2) of Commission Delegated Regulation (EU) 2016/1904 of 14 July 2016 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council with regard to product intervention.²
- 1.3 Article 18(1) of Regulation (EU) No 1286/2014 mandates EIOPA to perform a facilitation and coordination role in relation to actions taken by competent authorities under Article 17 of that Regulation. In particular, EIOPA shall ensure that action taken by a competent authority is justified and proportionate and that, where appropriate, a consistent approach is taken by competent authorities. Furthermore, Article 18(2) of Regulation (EU) No 1286/2014 mandates EIOPA, after receiving notification of any action that is to be imposed under Article 17 of that Regulation, to adopt an opinion on whether the

¹ OJ L 352, 9.12.2014, p. 1.

² OJ L 295, 29.10.2016, p. 11.

prohibition or restriction is justified and proportionate. In addition, if EIOPA considers that the taking of a measure by other competent authorities is necessary to address the risk, it shall state this in its opinion.

1.4 The Board of Supervisors adopted this Opinion in accordance with Article 2(7) of its Rules of Procedure.³

Background

1.5 On 7 September 2020, the Komisja Nadzoru Finansowego of Poland (KNF) informed the competent authorities concerned⁴ about its planned product intervention measure and sought their feedback in accordance with Article 17(2)(d) of Regulation (EU) No 1286/2014.

1.6 On 2 October 2020, the KNF notified EIOPA and the competent authorities of all EU Member States, except the United Kingdom, under Article 17(3) of Regulation (EU) No 1286/2014 of its intention to prohibit the marketing, distribution or sale in or from the territory of Poland of IBIPs with certain specified features (Notification).

1.7 Following the Notification, EIOPA performed a facilitation and coordination role in accordance with Article 18(1) of Regulation (EU) No 1286/2014. In this context, EIOPA set up a thematic platform under its Committee on Consumer Protection and Financial Innovation which served as a forum for exchange of views for competent authorities, including the KNF.

1.8 On 6 October 2020, EIOPA transmitted the Notification to the European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA) in view of possible cross-sectoral impacts. The EBA informed EIOPA that the planned product intervention measure by the KNF had no significant impact on the institutions and financial services that fall into the EBA's consumer protection remit. ESMA informed EIOPA that it did not see scope for a significant EU-wide cross-sectoral impact.

1.9 On 4 November 2020, EIOPA requested further information and evidence in relation to the Notification from the KNF which the KNF provided on 3 December 2020. This was followed with further exchanges and clarifications in order to ensure a proper assessment of the facts and actions of the KNF in the context of the planned product intervention measure.

³ Available at https://www.eiopa.europa.eu/sites/default/files/publications/administrative/bos-rules_of_procedure.pdf.

⁴ Competent authorities (i) of insurance undertakings pursuing insurance activity in Poland under the freedom of establishment or freedom to provide services, (ii) of those Member States where insurance undertakings established in Poland pursue insurance activity under the freedom of establishment or freedom to provide services (Germany, Ireland, Luxembourg, Netherlands, Romania and Slovakia), and (iii) of parent insurance undertakings of insurance the groups which consist of, among others, insurance undertakings authorised by the KNF (Austria, France and Italy).

- 1.10 The planned product intervention measure would apply to all unit-linked insurance products, except for unit-linked insurance products functioning as retirement products, individually continued group insurance contracts and closed books of business.
- 1.11 The KNF intends to adopt a decision introducing the product intervention by 31 March 2021. The planned product intervention measure intends to take effect on 1 October 2021.
- 1.12 Firstly, the planned product intervention measure aims at addressing significant investor protection concerns related to unit-linked insurance products that are unlikely to be profitable for investors.
- 1.13 Secondly, the product intervention aims at increasing the level of protection for investors that purchase unit-linked insurance products up to the level offered to direct investors in Undertakings for Collective Investment in Transferable Securities (UCITS)⁵ by prohibiting the investment of an investor's money (premium) in assets which:
- (i) offer the possibility of investing in asset classes other than those allowed for UCITS supervised by the KNF;
 - (ii) offer the possibility of concluding contracts relating to derivative instruments other than those allowed for UCITS supervised by the KNF;
 - (iii) offer the possibility of investing without appropriate spreading of the investment risk, i.e. in a way that does not ensure investor protection in terms of asset diversification and exposure limits at a level at least equivalent to the level set for UCITS supervised by the KNF;⁶
 - (iv) offer the possibility of investing in contingent convertibles (CoCos) issued to qualify as components of own funds of credit institutions, investment firms, insurance undertakings, or reinsurance undertakings.
- 1.14 Thirdly, the product intervention intends to prohibit the marketing, distribution or sale of the unit-linked insurance products that do not fully present information about fees actually collected, in which such information is provided in an incomplete, non-transparent or incomprehensible manner, or contracts which use phrases concerning fees that refer to vague terms or terms that do not exist in a given contract. This includes cases where there is no specific disclosure on fees charged by asset management companies for the provision of assets management services in relation to the assets of unit-linked insurance products and cases where remuneration received by insurance undertakings from asset management companies is not disclosed.

⁵ As defined in Article 1(2) of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

⁶ With the exception of the restrictions set out in Article 101(2) and Article 104(3) of the Polish Act on investment funds and management of alternative investment funds to allow to invest the whole premium in a particular UCITS.

1.15 Consequently, the planned product intervention measure would be based on three complementary criteria:

- (i) product profitability;
- (ii) asset classes in which the unit-linked insurance products invest in;
- (iii) the manner of presenting fees and commissions in insurance contracts.

1.16 As part of its supervisory review process, the KNF intends to use a dedicated supervisory tool to assess whether product manufacturers have appropriately applied the above referred three criteria. However, this tool will not be part of the product intervention measure. Consequently, it is also not subject of this Opinion.

1.17 Against this background, this Opinion provides EIOPA's views on the proposed product intervention measure presented in the Notification.

2. Justification of the proposed product intervention measure

2.1 In view of assessing whether the proposed product intervention measure is justified, EIOPA first assessed whether the conditions of Article 17(2) of Regulation (EU) No 1286/2014 have been fulfilled by the KNF.

Existence of significant investor protection concerns

2.2 The first condition for a prohibition set out in Article 17(2)(a) of Regulation (EU) No 1286/2014 is the existence of significant investor protection concerns arising out of an IBIP, or activity or practice.

2.3 According to Article 2(1) of Commission Delegated Regulation (EU) 2016/1904, in determining whether there exists significant investor protection concerns, all factors and criteria listed in Article 2(2) of that Commission Delegated Regulation should be assessed, but the existence of significant investor protection concerns can be based on one or more of those factors or criteria. The KNF based the identified investor protection concerns on the criteria listed in Article 2(2) (a), (b), (d), (e) and (f) of that Commission Delegated Regulation.

2.4 In justifying the planned product intervention measure and the existence of significant investor protection concerns, the KNF reported in the Notification consumer detriment related to various aspects of how unit-linked insurance products are designed.

2.5 Consumer detriment includes high costs for asset management services charged by external asset management companies that are passed on to investors.⁷ The KNF estimated that investors have been overcharged by approximately EUR 2.5

⁷ According to the evidence presented by the KNF, the average level of fund management charges for investors is 2.4% p.a..

billion during the last 10 years.⁸ In some cases, the costs to investors are negatively impacted by double fund management charges⁹ and by remuneration¹⁰ received by insurance undertakings from asset management companies in return for placing assets of unit-linked funds with them for management. Evidence provided by the KNF also indicates that biometric risk charges tend to be high when compared to the same level of cover provided by stand-alone life insurance policies. The KNF concluded that unit-linked insurance products sold in Poland are generally not profitable for consumers. The KNF reported that a market study¹¹ comparing product benefits and premiums paid revealed that the average rate of return to investors was negative, ranging from -1.6% to -6.7%, while the benefits to premiums ratio¹² ranged in general from 65% to 75%.¹³

2.6 The KNF also indicated that margins generated by the unit-linked insurance products¹⁴ are positive with values ranging from 5% to 20%. The KNF concluded that there is a substantial discrepancy between the value generated by the products for investors and the value generated for shareholders of insurance undertakings.

2.7 The KNF reported that some unit-linked insurance products have a significant exposure to participation units issued by external investment funds other than UCITS.¹⁵ ¹⁶ This led to a significant increase and materialisation of risks arising from the investment in instruments with high investment risk and low liquidity. Furthermore, the KNF also identified issues concerning the degree of transparency of the underlying assets of unit-linked insurance products¹⁷ and investors' limited capacity to fully understand the product's characteristics, complexity¹⁸ and risk profile. The KNF identified cases of mismatches between the asset classes pre-selected by insurance undertakings at the product design stage and the risk profile of investors.

2.8 The KNF identified consumer detriment resulting from inadequate cost disclosure to investors. Inappropriate practices reported by the KNF include the

⁸ Factors and criteria defined in Article 2(2)(b) of Commission Delegated Regulation (EU) 2016/1904.

⁹ Double fund management charges arise where the costs charged by insurance undertakings include fund management fees and, at the same time, the asset management company also charges fund management fees, in most cases directly deducted from the fund's value.

¹⁰ Includes one-off and ongoing commissions and other payments.

¹¹ Market study performed within the KNF's Risk Assessment Framework for the years of 2018 and 2019, performed in 2019 and 2020, respectively.

¹² The benefits to investors include the policy value taking into account the time value of money and other benefits such as death benefit computed using expected actuarial values.

¹³ Factors and criteria defined in Article 2(2)(f) of Commission Delegated Regulation (EU) 2016/1904.

¹⁴ Computed as discounted profits divided by discounted premiums, including lapses, cost of capital and risk margin.

¹⁵ According to the KNF, as at 30 September 2020, 7,6% of assets of unit-linked insurance products was invested in participation units issued by external investment funds other than UCITS, while a limited number of funds had an exposure above 85%.

¹⁶ Factors and criteria defined in Article 2(2)(e) of Commission Delegated Regulation (EU) 2016/1904.

¹⁷ Factors and criteria defined in Article 2(2)(d) of Commission Delegated Regulation (EU) 2016/1904.

¹⁸ Factors and criteria defined in Article 2(2)(a) of Commission Delegated Regulation (EU) 2016/1904.

use of complex cost structures and incomplete and unclear cost disclosures, which do not take into account the level of information available to the customers belonging to that target market and their financial literacy. The KNF also identified that the more complex the products, the less transparently the contractual provisions are disclosed.¹⁹

2.9 Taking into consideration the combined impact of all relevant factors and criteria identified by the KNF, EIOPA concurs with the KNF's conclusion that there exists a significant investor protection concern in the Polish insurance market that should be addressed.

2.10 Moreover, EIOPA notes that, while investor protection concerns relating to the value which some unit-linked insurance products offer to investors affect some other products in the European market, this problem appears to be widespread in the Polish unit-linked insurance market. The Polish unit-linked insurance market is an outlier in comparison to other European markets, despite the actions taken by the KNF and other competent authorities in Poland.

2.11 On average, the Polish unit-linked insurance market is more expensive than any other European market. Evidence gathered by EIOPA via the Costs and Past Performance exercise²⁰ shows that, in terms of reduction in yield (RIY) at the recommended holding period (RHP), the Polish unit-linked insurance market was the most expensive European market in 2018 and in 2019.²¹

2.12 In 2019, the average costs of the most representative unit-linked insurance products in the Polish unit-linked insurance market posted a RIY at the RHP of 3.7% against a European Economic Area (EEA) average of 2.5%. In 2018, the average costs of the most representative unit-linked insurance products in the Polish unit-linked insurance market posted a RIY at the RHP of 3.3% against an EEA average of 2.3%.

2.13 Similarly, a preliminary analysis, carried out by EIOPA for the purpose of this Opinion shows that particular investor protection concerns exist with regard to the Polish unit-linked insurance market. EIOPA analysed selected unit-linked insurance products sold by insurance undertakings using data from EIOPA's first Report on Cost and Past Performance²² and from an analysis of retail risk indicators.²³ A significant number of identified outliers are marketed in Poland. Moreover, assuming an average annual return of 3%, the vast majority of the

¹⁹ Factors and criteria defined in Article 2(2)(d) of Commission Delegated Regulation (EU) 2016/1904.

²⁰ The exercise is based on a representative sample of insurance undertakings accounting for around 60% of total unit-linked premiums.

²¹ EIOPA's first Report on Costs and Past Performance of insurance and pension products; available at https://www.eiopa.europa.eu/sites/default/files/publications/reports/costs_and_past_performance_2018_0.pdf and Cost and past performance 2020 report; available at https://www.eiopa.europa.eu/sites/default/files/publications/cost_and_past_performance_report_corrigendum.pdf.

²² Available at https://www.eiopa.europa.eu/sites/default/files/publications/reports/costs_and_past_performance_2018_0.pdf

²³ Gross written premiums, new contracts, new contract ratios, claims ratios, claims incurred, rejected claims, open claims, commission rates, expense ratios, combined ratios, surrenders, ongoing costs, return ratios.

products analysed in the Polish unit-linked insurance market would not break-even before the RHP because of the high costs. Results for products marketed in other markets are more mixed; confirming that the Polish unit-linked insurance is an outlier.

Existing regulatory requirements under Union law and improved supervision or enforcement

2.14 Article 17(2)(b) of Regulation (EU) No 1286/2014 requires that the competent authority should be satisfied on reasonable grounds that existing regulatory requirements under Union law applicable to IBIPs do not sufficiently address the risks and the issue would not be better addressed by improved supervision or enforcement of existing requirements.

2.15 The applicable existing regulatory requirements are set out in the following sectorial Union acts:

- (i) Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs);
- (ii) Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution;²⁴
- (iii) Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance;²⁵
- (iv) Commission Delegated Regulation (EU) 2017/653 of 8 March 2017 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs);
- (v) Commission Delegated Regulation (EU) 2017/2358 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to product oversight and governance requirements for insurance undertakings and insurance distributors.

Regulation (EU) No 1286/2014 and Commission Delegated Regulation (EU) 2017/653

2.16 Regulation (EU) No 1286/2014 lays down uniform rules on the format and content of the Key Information Document (KID) to be provided by manufacturers of PRIIPs to retail investors in order to help them understand and compare the key features and risks of a PRIIP. In particular, Article 8(3)(f) of Regulation (EU) No 1286/2014, sets out the requirements on how costs should be presented in the KID. According to this Article, the KID should contain a section entitled "What are the costs?", setting out the costs associated with an investment in the PRIIP, comprising both direct and indirect costs to be borne by the retail investor, including one-off and recurring costs, presented by means

²⁴ OJ L 26, 2.2.2016, p. 19.

²⁵ OJ L 335, 17.12.2009, p. 1.

of summary indicators of these costs and, to ensure comparability, total aggregate costs expressed in monetary and percentage terms, to show the compound effects of the total costs on the investment.

2.17 Commission Delegated Regulation (EU) 2017/653 details the requirements for calculating and presenting costs in the KID. Specifically, Annex VI and VII specify that the amounts shown in the KID are the cumulative costs of the product itself for three different holding periods, including potential early exit penalties, based on various assumptions, such as regarding the size and periodicity of the investment.

2.18 The objective of the KID is to allow retail investors to effectively understand and compare the key features of products. It is a summary document that is intended to supplement other more detailed contractual disclosures. It shall include all costs of the product itself and, where applicable, the costs of the distribution of the product, but does not contain a complete itemised list of, or description of, all cost elements. It shows the magnitude of all ongoing costs, but it does not show separately to retail investors the costs for asset management services charged by asset management companies nor remuneration received by insurance undertakings from asset management companies.

2.19 The proposed product intervention addresses irregularities and gaps identified by the KNF regarding how fees and commissions are disclosed to investors in contractual documentation. The requirements regarding the methodology for presenting costs specified in the PRIIPs KID Regulation apply exclusively to the KID, not to the method of presenting and the level of detail concerning costs in contractual documentation, such as tables of fees and commissions, rules for provision of services and general terms and conditions.

2.20 In light of the above considerations, existing regulatory requirements under Regulation (EU) No 1286/2014 and Commission Delegated Regulation (EU) 2017/653 do not sufficiently address the specific risks identified by the KNF in relation to the manner of presenting fees and commissions in insurance contracts.

Directive (EU) 2016/97

Information requirements

2.21 Directive (EU) 2016/97 sets detailed requirements to provide appropriate information to customers prior to the conclusion of a contract. In particular, Article 17(2) of that Directive requires Member States to ensure that all information, addressed by the insurance distributor related to the requirements of that Directive, to customers or potential customers, is fair, clear and not misleading. Article 23 of that Directive also requires insurance undertakings to provide information to their customers in a form of communication which is clear, accurate and comprehensible. Furthermore, Article 29(1) of that Directive

also requires, with regard to the distribution of IBIPs, specific disclosures related to costs and related charges. Directive (EU) 2016/97 allows information to be disclosed on costs and related charges to form part of the insurance contract or other contractual forms.

2.22 Article 29(1) of Directive (EU) 2016/97 requires that the information about all costs and charges, including costs and charges in connection with the distribution of the IBIP, which are not caused by the occurrence of underlying market risk, to be in aggregated form to allow the customer to understand the overall cost as well as the cumulative effect on the return of the investment, although an itemised breakdown of the costs and charges shall be provided to customers upon request.

2.23 Therefore, the product information requirements under Directive (EU) 2016/97 focus on the provision of information on costs of the distribution service connected to the IBIP in question, rather than on explicitly mandating disclosure to customers of the commercial payments which can flow between asset management companies and insurance undertakings in designing a unit-linked insurance product – for example, fees charged by asset management companies for the provision of asset management services or remuneration received by insurance undertakings from asset management companies. Nonetheless, the wording of Directive (EU) 2016/97 does not prevent Member States from applying a broader scope of disclosure, which can include fees and commissions related to asset management.

2.24 Article 17(1) of Directive (EU) 2016/97 requires that insurance distributors always act honestly, fairly and professionally in accordance with the best interests of their customers. Considering that the notion of “insurance distribution” in that Directive can be broadly interpreted as it covers also steps preparatory to the conclusion of the contract and because fairness and acting in the best interests of customers are concepts also reflected in the needs, interests and objectives of the target market in the product oversight and governance requirements in that Directive, this principle should also be considered at the product design stage, not just in the distribution process. The above principles are the basis for measures to be taken by insurance undertakings to safeguard the interests of customers.

2.25 In this context, EIOPA’s Opinion on monetary incentives and remuneration between providers of asset management services and insurance undertakings²⁶ states that Directive (EU) 2016/97 sets out principles for insurance undertakings to act in accordance with the best interests of their customers. The principles apply to conflicts of interest, including those resulting from monetary incentives received from asset management companies and to how the assets of unit-

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EIOPA-BoS-17/295;

available

at

https://www.eiopa.europa.eu/sites/default/files/publications/opinions/opinion_on_monetary_incentives_and_remuneration_between_providers_of_asset_management_services_and_insurance_undertakings.pdf.

linked policies are managed. The fact that assets of unit-linked policies are managed by third parties does not discharge insurance undertakings from this duty. Monetary incentives received from asset management companies may be a source of conflicts of interest and appropriate steps to prevent, identify, mitigate and manage the resulting conflicts of interest should be taken, considering the principles set out in that Directive. Where insurance undertakings disclose the monetary practices as a measure of last resort, investors should be provided with appropriate information regarding the general nature or source of the conflicts of interest prior to concluding the contract, including the nature of the monetary incentives received or, where that is not possible, the necessary information for evaluating the structure of the monetary incentives.

2.26 Lastly, it should be emphasised that Directive (EU) 2016/97 is a minimum harmonising directive, allowing Member States to maintain or introduce more stringent provisions (which are consistent with Union law) in order to protect customers, such as imposing stricter requirements on distributors to strengthen the transparency of cost disclosure under Articles 22(2) and 29(3) of that Directive.

2.27 In light of the above considerations, existing regulatory requirements under Directive (EU) 2016/97 can address the disclosure of fees and commissions at the product design stage and in the distribution process, regardless of whether that information is included in pre-contractual or contractual forms and materials.

Product oversight and governance

2.28 Product oversight and governance (POG) requirements set out in Article 25 of Directive (EU) 2016/97 and Commission Delegated Regulation (EU) 2017/2358 require product manufacturers to ensure that:

- (i) the insurance products they design and market are compatible with the needs, characteristics and objectives of the customers belonging to a clearly identified target market;
- (ii) their products are tested to assess how the products' characteristics are aligned with the needs, characteristics and objectives of the target market;
- (iii) the strategy for distribution of the products is compatible with the identified target market and takes into account the product characteristics;
- (iv) they monitor that products are distributed to the identified target market; and
- (v) they monitor products to identify possible detriment to the target market and periodically review them to ensure they remain aligned with the target market and that relevant risks are addressed.

In particular, Article 4(3) of Commission Delegated Regulation (EU) 2017/2358 requires that the product approval process shall:

- (a) ensure that the design of insurance products meets the following criteria:
 - (i) it takes into account the objectives, interests and characteristics of customers;
 - (ii) it does not adversely affect customers;
 - (iii) it prevents or mitigates customer detriment;
- (b) support a proper management of conflicts of interest.

Article 9 of that Commission Delegated Regulation furthermore provides that relevant actions taken by product manufacturers in relation to their product approval process shall be duly documented, kept for audit purposes and made available to the competent authorities upon request.

2.29 In accordance with Commission Delegated Regulation (EU) 2017/2358, for products manufactured and sold on or after 1 October 2018, insurance undertakings as product manufacturers are required to test their products before they are commercialised, including by assessing whether their features, including costs, are aligned with the objectives, needs and characteristics, including financial literacy of the target market. As part of the product testing process, product manufacturers should assess whether products offer value for the target market. Pursuant to Article 25(1) of Directive (EU) 2016/97 and Articles 5 and 7 of that Commission Delegated Regulation, for all products manufactured and sold after 1 October 2018, product manufacturers are also required to continuously monitor and review them and take appropriate action to mitigate any circumstances that may adversely affect the target market.

2.30 Against this background, Union law provides POG arrangements which ensure that the design of products brings value to customers and meets the needs, characteristics and objectives of the identified target market. Commission Delegated Regulation (EU) 2017/2358 applies to all products manufactured or sold on or after 1 October 2018, thereby it could address the risks identified by the KNF. For products manufactured and sold before 1 October 2018, product manufacturers are also required to test those existing products and continuously monitor and review them and take appropriate action to mitigate any circumstances that may adversely affect the target market when any changes made to those products constitute a significant adaptation²⁷.

²⁷ See EIOPA Question & Answer Nos [XX] and [XX] endorsed by the European Commission regarding scope of retrospective application of POG requirements and notion of "significant adaptation" of existing products. According to that Question & Answer, whether an adaptation is "significant" has to be primarily assessed from the perspective of the average customer and "an important criterion consists in the question whether the adaptation of the insurance product changes the compatibility of the product with regard to the target market and requires an adaptation of the target market".

Directive 2009/138/EC

Investments

- 2.31 Article 132 of Directive 2009/138/EC introduces the “prudent person principle” which includes provisions on how insurance undertakings should invest their assets, in particular the requirement for insurance undertakings to take investment decisions with regard to prudence and in the interest of investors.
- 2.32 It requires insurance undertakings to only invest in assets and instruments whose risks the insurance undertakings can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of its overall solvency needs. Assets must be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole.
- 2.33 The prudent person applies to the whole portfolio of assets and to assets held in respect of life insurance contracts where the investment risk is borne by the policyholders as provided by Article 132(3) of Directive 2009/138/EC and to individual unit-linked insurance products.
- 2.34 The principle of investing in the best interest of investors is further underlined in Guideline 25 of EIOPA’s Guidelines on System of Governance²⁸ which states that with regard to investments, in its risk management policy, insurance undertakings should cover how the assets are to be selected in the best interests of investors and beneficiaries. Guideline 32 applies the same principles to the investments of unit-linked insurance products.
- 2.35 The prudent person principle sets out broad principles that should be considered by insurance undertakings when selecting the asset classes in which the unit-linked insurance product invests. Pursuant to Directive 2009/138/EC investments are not restricted by external requirements setting reference values, limits or restrictions with respect to specific asset classes or asset types. However, the absence of regulatory limits on investments does not mean that insurance undertakings can take investment decisions without any regard to prudence and to the interests of investors.
- 2.36 In addition, Article 133(3) of Directive 2009/138/EC allows Member States to introduce requirements limiting the types of assets or reference values that may be associated with the benefits of the policy when the investment risk is borne by investors who are natural persons. These must not be more stringent than the provisions of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (UCITS Directive).²⁹

²⁸ EIOPA-BoS-14/253; available at https://www.eiopa.europa.eu/content/guidelines-system-governance_en.

²⁹ OJ L 302, 17.11.2009, p. 32–96.

2.37 Regarding the prohibition of unit-linked insurance products that do not exclude investing in CoCos issued to qualify them as components of own funds by credit institutions, investment firms, insurance undertakings or reinsurance undertakings, there are no specific provisions in Directive 2009/138/EC that could be used as legal basis to impose such a restriction at the national level. The provisions under Article 133(3) of that Directive cannot apply to this type of asset in general, as this would be more stringent than the provisions of the UCITS Directive. While the UCITS Directive contains risk management and diversification measures together with certain investment limits these do not appear to prohibit CoCos. The prudent person principle likewise puts in place limits on the risks that should be taken on, but does not thereby set a clear basis for an outright prohibition.

2.38 In light of the above considerations, existing regulatory requirements under Directive 2009/138/EC partially address the specific risks identified by the KNF in relation to the assets held by unit-linked insurance products. These requirements could be used to increase the level of protection for investors that purchase unit-linked insurance products up to the level offered to direct investors in UCITS. However, these could not be used to prohibit the marketing, distribution or sale of unit-linked products investing in CoCos.

Information for investors

2.39 Article 185(4) of Directive 2009/138/EC requires insurance undertakings, before the life insurance contract is concluded to provide specific information in order to provide a proper understanding of the risks underlying the contract which are assumed by the investor. Furthermore, based on Article 185(7) of that Directive Member States may require life insurance undertakings to furnish additional information if it is necessary for a proper understanding by the investor of the essential elements of the commitment.

2.40 These requirements can help investors to understand the specificities and risks of underlying assets in their unit-linked insurance products. Where appropriate, additional information on fees and commissions in relation to asset management services can be prescribed by the Member States. As the information objective of Directive 2009/138/EC is to provide the consumers with whatever information is necessary before the conclusion of the contract, the format of that information is not decisive. Consequently, the prescribed information can be included in any contract forms, including general terms and conditions, tables of fees and commissions and rules for provision of services provided to the consumers before the conclusion of a contract.

2.41 With regard to the above, the broad scope of information requirements under Directive 2009/138/EC, together with the option for Member States to require additional information, provide sufficient legal basis to prescribe specific disclosure on fees and commissions related to asset management services. This

legal basis applies for pre-contractual disclosure regardless of the contract form used by the given insurance undertaking.

The KNF's assessment on the proportionality of the action

2.42 Article 17(2)(c) of Regulation (EU) No 1286/2014 requires that the proposed product intervention measure is proportionate, taking into account the nature of the risks identified, the level of sophistication of investors concerned and the likely effect of the action on investors who may hold, use or benefit from IBIPs.

2.43 In response to unfair customer treatment and in order to prevent further detriment to customers' interest, the KNF has concluded that the proposed product intervention measure is proportionate. The KNF is of the view that the proposed product intervention measure, based on three complementary criteria addresses the identified significant investor protection concerns related to unit-linked insurance products in the Polish market without going beyond its intended purpose.

2.44 The KNF has gathered evidence that shows that the average customer buying unit-linked insurance products has limited financial experience and skills. This aspect is relevant in view of product complexity and the degree of transparency regarding assets held by unit-linked insurance products and cost structures. This has led to a widespread mismatch between the product characteristics and the customers' needs, demands, ability to bear losses, and investment objectives, including their risk tolerance. The KNF has also concluded that the planned product intervention measure should have a positive impact on current and future investors by reducing costs, mitigating investment risk and increasing transparency.

2.45 In the KNF's view the intervention is an appropriate and optimum measure as the malpractices concerning unit-linked products in Poland have persisted since 2014 and other measures taken either by the KNF or other authorities in Poland competent for consumer protection have not solved the problem. Moreover, there is evidence which shows that self-regulation of the market would not address the whole spectrum of the existing irregularities.

Consultation with the competent authorities concerned

2.46 In accordance with Article 17(2)(d) of Regulation (EU) No 1286/2014, the KNF is required to properly consult competent authorities in other Member States that may be significantly affected by the action.

2.47 In September 2020, the KNF consulted the competent authorities of other Member States that might be significantly affected with the proposed product intervention measure. The KNF informed them about the planned product intervention measure, providing details on evidence gathered in the Polish unit-linked insurance market, the justification, the scope and the specificities of the proposed product intervention measure. The KNF requested the consulted

competent authorities to indicate whether they had concerns, considered taking similar actions or sought further clarifications.

Discriminatory effect

2.48 According to Article 17(2)(e) of Regulation (EU) No 1286/2014, the prohibition cannot have a discriminatory effect on services or activities provided from another Member State.

2.49 The planned product intervention measure applies equally to all insurance undertakings operating in Poland, including insurance activities carried out by insurance undertakings from other EU Member States on the Polish territory under the principles of freedom of establishment and freedom to provide services. Furthermore, EIOPA is not aware, and the KNF has provided no indication, that the planned product intervention measure in connection with Polish legislation may lead to a direct or indirect preferential treatment of Polish customers by Polish insurance undertakings vis-à-vis insurance undertakings from other Member States. Accordingly, EIOPA concurs with the KNF's view that the planned product intervention measure does not have an obvious discriminatory effect on services or activities provided from another Member State.

3. EIOPA's assessment on the proportionality of the proposed product intervention measure

3.1 Product intervention measures interfere with the fundamental rights and freedoms of insurance undertakings. To give those rights and freedoms sufficient consideration, the KNF must ensure that any limitations to the fundamental rights and freedoms of insurance undertakings are in line with Articles 52 and 62 of the Treaty on the Functioning of the European Union ("TFEU") and Article 52 of the Charter of the Fundamental Rights of the European Union ("Charter") respectively. EIOPA is aware that the planned product intervention measure affects, in particular, the insurance undertakings' freedom of establishment under Article 49 TFEU and their freedom to provide services under Article 56 TFEU, as well as their freedom to choose an occupation and their right to engage in work under Article 15 of the Charter and their freedom to conduct a business under Article 16 of the Charter. However, having regard to the consumer protection objective pursued by the planned product intervention measure, any limitation to the freedoms and rights of the insurance undertakings are justified by overriding reasons relating to public interest.

3.2 Taking into consideration the principle of proportionality, enshrined in Article 52(1) of the Charter, EIOPA has assessed whether there are other measures, including less restrictive binding or non-binding regulatory or supervisory measures the KNF is empowered to use, which would be equally or more appropriate to address the identified concerns.

- 3.3 The KNF has no power under national law to issue any binding legal regulation to the insurance sector. Its scope of action is limited binding and non-binding supervisory measures and enforcement of the applicable laws and regulations. On the other hand, the KNF can engage with the Polish legislator in view of adopting national rules based on the existing regulatory requirements under Union law.
- 3.4 Since 2014, the KNF has acted on risks identified in the unit-linked insurance market. These have been complemented by actions by other competent authorities in Poland, such as the Office for Competition and Consumer Protection and the Financial Ombudsman.
- 3.5 The KNF's activities have consisted of issuing market-wide recommendations (issued on comply-or-explain basis), guidelines, statements (in particular the Statement of 17 July 2019³⁰ concerning the aspects of product design, distribution and asset management of unit-linked insurance products) and meetings with industry. Compliance by the insurance industry has mainly been verified by the KNF through self-evaluation surveys, assessment of the implementation of recommendations and guidelines, on-site inspections and through the Risk Assessment Framework. Moreover, the KNF has also issued administrative decisions, including imposing financial penalties.
- 3.6 Against this background, EIOPA assessed the proportionality of each aspects of the planned product intervention measure separately.

Product profitability

- 3.7 Identifying and eliminating the risks in scope of the planned product intervention measure at the design stage is the approach set out by the KNF. The combination of the requirements regarding the product approval process in Article 4(3) and the record-keeping requirement in Article 9 of Commission Delegated Regulation (EU) 2017/2358 provide a clear hook for effective supervision of how the products in question were designed with the interests of policyholders in mind and with a view to preventing customer detriment and appropriately managing conflicts of interest.
- 3.8 However, given the current situation, POG requirements, *per se*, would not address in a consistent way the risks identified by the KNF. Product manufacturers pursue various methods to product testing resulting in different levels of consumer protection across the market. Clarifications, guidance and detailed specifications would be needed to ensure that insurance product manufacturers apply the principles in a consistent manner across the market, so as to achieve consistently high levels of consumer protection.

³⁰ Available at https://www.knf.gov.pl/knf/pl/komponenty/img/Stanowisko_UKNF_dot_UFK_66545.pdf.

- 3.9 Moreover, POG requirements, *per se*, would not address the risks identified by the KNF in a sufficiently timely manner given the significant investor protection concerns identified. Although POG requirements could, in the longer-term, address risks related to product profitability, EIOPA notes that their effectiveness in the Polish market would require immediate, significant and extensive supervisory attention to ensure that POG requirements are implemented in a way that products are tested to ensure they bring value for money to investors.³¹ This means that supervisory actions aimed at an effective and highly consistent application of POG requirements might not have an immediate impact on market practices.
- 3.10 Moreover, the fact that for some products, POG requirements are already applicable while, for others, the application of POG requirements would only result after a full product review or if there has been a significant adaptation to the product, the application of POG requirements in the medium term would not ensure an even level of consumer protection for all investors.
- 3.11 The KNF reported a substantial discrepancy between the value generated by the products for customers and the value generated for shareholders of insurance undertakings. The value of products should be evaluated, not only in terms of the return on the investment component but also in relation to the insurance coverage and scope of the service provided. Nevertheless, given that the products sold in the Polish market do not include capital guarantees, the high level of costs applied to the products might not be justified by the product features.
- 3.12 Accordingly, while, the planned measure can be effective in addressing the identified significant investor protection concerns by directly tackling costs, an approach which covers a wider scope of key product characteristics and target markets needs, characteristics and objectives for evaluating the value unit-linked insurance products offer to the target market is more suitable.
- 3.13 In addition, EIOPA questions whether a 50% split of the gains from the unit-linked product between investors and insurance undertakings may be imposed. The KNF explained that this parameter was already present in the Polish legal environment related to pension system and considered as a measure of fair distribution of profits between pension companies and its customers.
- 3.14 The planned product intervention measure should be revised to address drawbacks identified by EIOPA. In particular, the application of the profitability criterion to products regardless of the target market could potentially drive products– out of the market. This might be the case when specific product features may be targeted to specific target markets who can bear the risks while

³¹ See "Fairness Testing" in [EIOPA's Approach to the Supervision of Product Oversight and Governance](#).

seeking the expected rewards – e.g. targeted for professional investors³² Professional investors should have access to their preferred unit-linked insurance product, if they are correctly targeted and appropriately sold. Accordingly, the scope of the product intervention should take into account this aspect.

3.15 The correlation of the profitability criterion to the risk-free-rate (RFR), presents some limitations as financial markets are in continuous evolution. The changes in the RFR could drive products out of the market that previously pass the test. Specifically, if the RFR were to be too low the significant investor protection concerns identified because of the high costs would persist given most products would pass the “compliance test”. On the contrary, if the RFR were to be too high it may drive low cost and low risk products out of the market. It is unclear what would be the effect of this measure on the in-force business.

3.16 Finally, the profitability criterion of the planned product intervention measure may adversely impact long-term products. As the criterion is designed, in case a product has a RHP higher than 10 years, the profitability criterion should be satisfied at both the RHP and at 10 years of policy. In the KNF’s view, this ensures that in the case of policies with RHP longer than 10 years, investors obtain a reasonable return within 10 years and, in the case of early terminations before the RHP, do not suffer substantial losses. This threshold takes into account the actual holding period of unit-linked insurance products in the Polish market (5 to 10 years). A more flexible approach to the short-term test could be applied, taking into consideration a duration linked to the actual RHP instead of a fixed 10 years term.

3.17 Accordingly, for products which are clearly designed for sufficiently granular target markets looking for a long-term investment and with the ability to keep such investment for a long-period the 10 year benchmark should be revised.

Asset classes in which the unit-linked insurance product invest in

3.18 Regarding the assets held by unit-linked insurance products, the KNF could use the broad discretion of Member States to introduce specific investment rules for the protection of customers under Article 133(3) of Directive 2009/138/EC and engage with the Polish legislator to this end. Additional national restrictions on certain categories of underlying assets of unit-linked insurance products and national diversification rules would apply to Polish insurance undertakings. However, as the Polish unit-linked insurance market is dominated by local insurance undertakings³³, it could effectively address the investor protection concerns identified.

³² By analogy to Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments, a professional investor is an investor that possesses the experience, knowledge and expertise to make its own investment decisions and properly assess the risks incurred.

³³ In 2020, approx. 1.7% of the national gross written premium from unit-linked or index-linked business came from foreign insurance undertakings operating on a freedom to provide services and freedom of establishment basis.

- 3.19 In addition, the KNF should assess whether additional national provisions can qualify as general good rules. National provisions adopted in the interest of the general good must comply with the requirements developed by the case-law of the Court of Justice of the European Union and explained in the Commission Interpretative Communication on freedom to provide services and the general good in the insurance sector (2000/C 43/03). If the conditions of their application are met, national provisions may also apply to insurance undertakings providing insurance activities in Poland based on the freedom to provide services and freedom of establishment. Other Member States used additional measures as general good rules to limit or prohibit unit-linked insurance contracts from investing in certain asset classes or types.
- 3.20 With regard to the above, regarding the risks identified by the KNF in relation to the assets held by unit-linked insurance products and, specifically, the KNF's aim to ensure that the protection of investors in unit-linked insurance products up to the level offered to direct investors in UCITS, EIOPA is of the opinion that the KNF should further explore the use of other regulatory or supervisory measures, including the introduction of additional requirements in national legislation.
- 3.21 The risks associated with investing in CoCos has been highlighted by the Joint Committee of the European Supervisory Authorities³⁴ and by ESMA in a statement to the market³⁵ while competent authorities have also taken supervisory measures to protect investors. For instance, in 2014, prior to the entry into force of Regulation (EU) No 1286/2014, the Financial Conduct Authority of the UK has imposed a temporary restriction in relation to the retail distribution of contingent convertible instruments.³⁶
- 3.22 Against this background, although CoCos presently represent a marginal share of assets of unit-linked insurance products, the KNF may consider, as a preventive measure, to impose a temporary prohibition on the marketing, distribution or sale of unit-linked insurance products investing in CoCos.

The manner of presenting fees and commissions in insurance contracts

³⁴ Available at https://www.esma.europa.eu/sites/default/files/library/2015/11/jc_2014-62_placement_of_financial_instruments_with_depositors_retail_investors_and_policy_holders_self_placement.pdf.

³⁵ ESMA/2014/944 – Statement on Potential Risks Associated with Investing in Contingent Convertible Instruments; available at https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-944_statement_on_potential_risks_associated_with_investing_in_contingent_convertible_instruments.pdf.

³⁶ Available at <https://www.fca.org.uk/your-fca/documents/temporary-product-interventions/restrictions-in-relation-to-the-retail-distribution-of-contingent-convertible-instruments>.

- 3.23 Regarding the risks associated with how costs are disclosed to investors, the KNF could have partially addressed the risks by using its supervisory measures or by legislation, where appropriate.
- 3.24 Directive (EU) 2016/97 sets out the relevant requirements on how information should be provided to customers prior to the conclusion of a contract. Specifically, the second subparagraph of Article 29(1) of that Directive regarding the itemised breakdown of the costs to be provided at the customer's request provided the basis for the KNF to have specified the form and content of an itemised breakdown of costs which all insurance undertakings would need to prepare. The itemised breakdown could include any fees or commissions related to asset management services. In addition, Directive (EU) 2016/97 is a minimum harmonising directive, allowing Member States to maintain or introduce additional disclosure rules to protect customers.
- 3.25 Furthermore, in the context of the communication of essential information before the conclusion of a life insurance contract, Article 185(7) of Directive 2009/138/EC empowers Member States to require additional information that is necessary for the proper understanding of the essential elements of the commitment. On this legal basis insurance undertakings could be required to provide information about fees and commissions related to asset management services in any contract form provided to the customer before conclusion of the contract.
- 3.26 Notwithstanding the importance of pre-contractual disclosure and of the full use of the available tools under Union law, EIOPA disagrees with the KNF's conclusion that existing requirements under Union law do not provide any regulation regarding terms and conditions of insurance contracts. In some Member States, national competent authorities have powers to address the terms and conditions of insurance contracts under Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts³⁷, if there is a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer.
- 3.27 In addition, Article 17(2) of Directive (EU) 2016/97 explicitly states that it is without prejudice to the application of Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market.³⁸ The regulation of that Directive applies to all commercial practices that occur before, during and after a business-to-consumer transaction has taken place. It provides that Member States can retain or add information requirements relating to contract law where this is permitted by minimum harmonisation clauses found in existing EU legal instruments. Therefore, in areas where Directive (EU) 2016/97 is a minimum harmonising as regards disclosure requirements, a Member State could use

³⁷ OJ L 95, 21.4.1993, p. 29.

³⁸ OJ L 149, 11.6.2005, p. 22–39.

Directive 2005/29/EC as a basis to impose stricter requirements relating to the disclosure of contractual provisions to consumers.

Additional considerations

3.28 In determining whether there are significant investor protection concerns, the KNF, in line with Article 2(2)(c) of Commission Delegated Regulation (EU) 2016/1904, should also consider the type of investor to whom an IBIP is marketed or sold. To ensure proportionality, professional investors³⁹ and thereby products targeted clearly and specifically at professional investors should be excluded from the scope of the product intervention. The investor protection concerns identified by KNF, in particular regarding the degree of transparency of the underlying assets of unit-linked insurance products and investors' capacity to understand the product's characteristics, complexity and risk profile, do not apply to professional investors.

3.29 The principle of legal certainty must be also thoroughly considered by the KNF in the decision to be adopted. It should be clear to insurance undertakings and also to investors which unit-linked insurance products fall under the scope of the product intervention. Article 17(1) of Regulation (EU) No 1286/2014 requires the KNF to determine the specific features of the IBIPs to which the prohibition applies and this requirement has to be implemented in the product intervention decision.

4. Action by other competent authorities

4.1 According to Article 18(2) of Regulation (EU) No 1286/2014, if EIOPA considers that the taking of a measure by other competent authorities is necessary to address the risk, it shall state this in the opinion.

4.2 The significant investor protection concern identified by the KNF affects the Polish market. The Polish unit-linked insurance market differs from other European markets in terms of typical product features. Most products are pure unit-linked insurance products⁴⁰ and the evidence provided by the KNF indicates that product are more costly.

4.3 While competent authorities consulted have not informed EIOPA or the KNF about similar risks in their respective market, it remains a core duty of competent authorities to monitor their markets and take supervisory measures where conduct risk has been identified. Accordingly, where similar consumer

³⁹ A professional investor is an investor that possesses the experience, knowledge and expertise to make its own investment decisions and properly assess the risks incurred.

⁴⁰ I.e. unit-linked insurance products without financial guarantees and without annuity options.

protection issues have been identified in other Member States, competent authorities are expected to take supervisory action.

4.4 Competent authorities should tailor supervisory measures to the specificities of the risks identified in their respective markets and are not expected to take the same product intervention measure as the KNF. Firstly, these have been designed by the KNF in response to the specific investor protection concerns identified in the Polish market. Secondly, any intended supervisory action should take into account the objective of the use of product intervention powers under Regulation (EU) No 1286/2014. These powers are a last resort measure and competent authorities should consider the full array of supervisory tools to address identified risks. Thirdly, there are common conduct risks across Member States which warrant wider and coordinated action at EU level.

5. Conclusions

5.1 EIOPA concurs with the KNF's conclusion on the existence of significant investor protection concerns in the Polish unit-linked insurance market and is strongly supportive of regulatory or supervisory measures aimed at addressing those concerns.

5.2 Product intervention powers under Regulation (EU) No 1286/2014 are intended as a last resort measure and should be used by competent authorities under the strict conditions set out in Article 17(2) of that Regulation. Competent authorities should also take into account that the objective of product intervention is to address and prevent specific significant investor protection concerns, thereby this power cannot be used for general market regulation purposes.

5.3 EIOPA is of the opinion that with regard to the risks arising from product profitability, a targeted product intervention measure is justified and proportionate with regard to persisting risks of consumer detriment in the Polish market, the clear outlying nature of the Polish unit-linked insurance market in terms of costs and the need to address this risk in a consistent and timely manner.

5.4 In view of ensuring legal certainty and proportionality of the product intervention, the KNF should closely monitor the effects of the targeted product intervention measure and adjusts the parameters of the criterion on product profitability to ensure that the measure remains effective and achieves the targeted outcome.

5.5 In addition, in EIOPA's view the KNF should assess how the detriment for investors that have already invested in and/or continue investing in unit-linked insurance products that are otherwise banned as a result of the product intervention can be addressed.

- 5.6 Regarding the risks arising from how assets of unit-linked insurance products are invested, EIOPA is of the opinion that the KNF could engage with the Polish legislator in view of providing national rules to achieve a level of investment protection up to the level offered to direct investors in UCITS. Consequently, a product intervention measure to achieve the desired level of investment protection is only justified and proportionate with regard to the intended prohibition of investment in CoCos. To this end, the KNF should consider adopting a separate decision in view of the narrow and specific scope.
- 5.7 Regarding the risks arising from the manner of presenting fees and commissions in insurance contracts, EIOPA is of the opinion that the scope of pre-contractual disclosure could be extended to any fees and commissions related to asset management services under Directive (EU) 2016/97 by other supervisory measures the KNF is empowered to use. Furthermore, the KNF could engage with the Polish legislator, where appropriate, to enhance the scope of disclosure also in insurance contracts since information requirements under Directive 2009/138/EC concern any contract forms, including contractual documentation provided to the customer before conclusion of the contract.
- 5.8 Consumer protection issues with regard to the unit-linked insurance market have also been identified in some other Member States. Competent authorities should monitor their markets and, where risks emerge, use the necessary and proportionate regulatory and supervisory tools considering the specificities of their market. The existence of significant cross-border business and of similar risks in the European unit-linked insurance market, warrants wider, coordinated action, which EIOPA is committed to take.
- 5.9 This Opinion will be published on EIOPA's website in accordance with Article 18(2) of Regulation (EU) No 1286/2014.

Done at Frankfurt am Main, [*]

[signed]

For the Board of Supervisors

Chairperson