ASSOCIATION DES COMPAGNIES
D'ASSURANCES ET DE RÉASSURANCES
DU GRAND-DUCHÉ DE LUXEMBOURG

ACA response to the ESAs Joint Consultation on RTS

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Executive Summary

Since the entry into force of SFDR, the insurance sector has welcomed all regulatory obligations on sustainability disclosure, even opting for the extensive interpretation of some unclear regulatory provisions in order to ensure the most complete disclosure to clients.

However, the consultation document published by the ESAs has increased the regulatory obligations on insurance companies offering Multi-Option Products (MOP) products, revealing an unsustainable and disproportionate burden related to the operational implementation in relation to pre and post contractual as wells as the website disclosure. Therefore, with this document, the Association of Luxembourg Insurance Companies (ACA) offers to the ESAs the chance to deepen the features related to the Investment-based Insurance Products (IBIPs) based on an open architecture model.

In the event that the ESAs agree with the detected issues, this document also offers an overview of alternative solutions aimed at amending the ESAs consultation document in order to be able to ensure that insurance companies can continue to offer a wide range of sustainable investment solutions to clients.

ACA proposals to the ESAs Joint Consultation on RTS

The consultation of the ESAs foresees amendments, among other things, of the regulation concerning the Multi-Option Products (MOPs). In the various reports and interventions published in recent years, the ESAs have often clarified that the regulation of MOPs has been designed to refer mainly to Investment-based Insurance Products (IBIPs) which normally have a multi-level supply structure. In this regard, it should be noted that the IBIP structures could be particularly complex and present significant differences in the various European countries depending on where they are issued and distributed, in consideration of the specific applicable regulations, value propositions and market trends.

In this sense, the typical structure of the so-called "open architecture" product provides that the investment options can be based on investment supports that are also very different from each other. In particular, such investment supports may take the form of an existing and commercialized UCITS or an internal insurance fund. In the latter case, some EU domestic regulators are foreseeing and defining the rules of collective, dedicated or specialized funds that insurance carriers can set up and offer as investment options of their MOP products.

Since the publication of Regulation 2019/2088 and even more with the text of the RTS, operators belonging to the insurance market have encountered several issues from an interpretational point of view around the definition of "financial product" established and commonly used by the EU legislator which did not consider the insurance fund within it. Indeed, “insurance funds” are not falling within the definition of “financial product”. The non-inclusion of such structure has immediately forced the insurance sector to face interpretative issues around the provisions relating to the MOPs which mainly apply in the event that the underlying investment options are themselves qualified as financial products under SFDR. In addition, the hypothesis around which investment option could not be qualified as a "financial product" was taken into consideration on a residual basis only in the case of investment option that has sustainable investment under art. 20 par. 3 lett. c) of Del. Reg. 2022/1288.

Despite the above, a consistent part of the insurance market has gone in the direction of considering, even in the absence of a specific provision set out by the EU legislator, the insurance fund as a financial product taking into account its similarity to the portfolio management activity in relation to the investment structure and, therefore, for the purpose of guaranteeing adequate disclosure of sustainability factors. This interpretation was favourably taken into account by many operators since it would have proved to be the most prudent, given that it would have guaranteed to IBIP subscribers a complete disclosure on sustainability regardless of the investment support offered and chosen.

As per our understanding, this extensive interpretation has never been confirmed or clarified by the EU legislator but its implementation has in any case proved to be acceptable in terms of operational burden considering the disclosure obligations envisaged in the first version of the RTS. In fact, the role of the insurance company turned out to be, as a whole, limited in the case of IBIP in consideration of the fact that investment decisions (and therefore assessments of sustainability factors) are entrusted to independent investment managers. Therefore, since the investment managers are in any case obliged to provide the insurance company (formally as a client of the manager) with the disclosure on sustainability characteristics envisaged by the SFDR, to date the latter is limited to transmitting the same information to policyholders, thus satisfying the disclosure obligations associated with the IBIP product.

However, the overall framework explained above is now completely disregarded by the changes proposed by the latest consultation document carried out by the ESAs. In particular, the proposed changes would seem to bring the disclosure obligations for MOPs even closer to those applicable to standard financial products, entailing an increased operational burden not foreseen and implementing issues due to the structure and the dependence on independent investment manager and/or investment fund and that cannot be carried out by the insurance companies.

For this reason, we are providing you with an extensive analysis on the main points of the consultation which we consider as detrimental for the insurance companies, especially from an operational risk point of view, and alternative solutions.

1. Amendments to Annex II/III/IV/V for MOPs

As already anticipated above, the Luxembourgish insurers provide a range of IBIPs based on an open-architecture model. The investment parameters for those solutions and the principles of their underlying assets allocation are determined by the insurer in accordance with its own investment strategy, Luxembourgish law and, often, insurance law and taxation in policyholders' countries of residence. However, investment decisions are ultimately taken either by independent investment managers appointed by the insurer (in case of Internal funds) or investment fund issuers selected by the policyholder (in case of direct investment in UCITS). As such, it is the independent investment manager and/or investment fund issuer who is responsible for the integration of sustainability risk(s) into investment decision making and the assessment of the likely impacts of sustainability risk(s) on investment returns.

This is the reason why, on the basis of art. 20 and 21 of EU Reg. 2022/1288, the sustainability disclosure at investment option level is provided to the insurer by the independent investment manager and/or investment fund issuer. In particular, insurers, being formally the investors under the investment manager and investment fund issuer perspective, receive from these entities the relevant versions of Annex II/III/IV/V and forward them as they are to clients to whom those investment options are offered. This procedure, even if today seems to be quite smooth and automated when compared to the one proposed by the ESAs in the consultation document, comes with some complexities depending on the practical modalities used especially by investment managers to communicate the Annexes to insurance carriers that are working in partnership with hundreds of different investment managers.

However, the new version of art. 20 par. 4 states the following: "*Financial Market Participants (FMPs) shall present the information referred to in paragraph 3, point (a), in the form of the template set out in Annex II and the information referred to in paragraph 3, point (b), in the form of the template set out in Annex III. For this purpose, references to 'product' and 'financial product' in the templates shall be*

replaced by 'investment option'". The equivalent amendment has been provided also for art. 21 par. 4, art. 49e par. 2(b), art. 49f par. 2(b), art. 49i par 2(b), art. 65 par. 3 and art. 66 par. 3.

The insurance sector considers this new obligation as particularly detrimental as it will oblige the insurer to carry out a substantial redefinition of a new process envisaging the manual amendment of every single version of Annex II/III/IV/V provided by the investment managers/investment fund issuers in order to replace the wording "product" and "financial product" with "investment option". It is, indeed, very clear that this amendment will not be made by the investment managers/fund issuers which do not ultimately fall under this specific regulatory obligation. Taking into account that the vast majority of Luxembourgish insurers offers to clients thousands of investment mandates/UCITS issued by hundreds of investment managers/investment fund issuers, this burden would surely be unsustainable for the insurance sector from an operational point of view and, from a business perspective, would lead to a restriction of the offer of art. 8/9 investment options to clients in order to be able to comply with the new regulatory obligations.

Proposed solution

In light of the above, the insurance sector invites the ESAs to amend the wording of art. 20 par. 4, art. 21 par. 4, art. 49e par. 2(b), art. 49f par. 2(b), art. 49i par 2(b), art. 65 par. 3 and art. 66 par. 3 aiming at i) avoiding diverging interpretations and ii) preventing an avoidable effort from the insurance sector, i.e. specific manual intervention on every single disclosure documents. In this regard, the industry is proposing an alternative solution which allows the insurers to include a general disclaimer in the pre and post-contractual documentation, as well as part of website disclosure, where it is generally indicated that any reference in Annex II/III/IV/V (and in the relevant website disclosure) to the wording "product" and "financial product" should be considered as "investment option".

2. New website disclosure provisions in case of MOPs

The ESAs consultation includes also a new section related to the website disclosure in case of MOPs structures that is currently absent in Reg. 2022/1288. In particular, under new art. 49a is provided that, "*By way of derogation from Section 1, where a financial product offers investment options to the investor and one or more of those investment options qualify that financial product as a financial product that promotes environmental or social characteristics, financial market participants shall publish the information referred to in Article 10(1) of Regulation (EU) 2019/2088 and Articles 49b to 49f of this Regulation in the following order and made up of all of the following sections titled: (a) 'List of investment options that promote environmental or social characteristics'; (b) 'List of investment options that have sustainable investment as their objective'; (c) 'Summary'; (d) for each investment option that promotes environmental or social characteristics 'Investment option information: environmental or social characteristics'; (e) for each investment option that has a sustainable investment objective, 'Investment option information: sustainable investment objective'*". The equivalent provision has been included under new art. 49f (new section 4) in case of art. 9 products.

It is clear that the above amendments proposed by the ESAs are aimed at guaranteeing an equivalent level of website disclosure for investment options as for standard financial products. In particular, insurers are now required to provide a complete website disclosure related to every single investment option with specific obligations in terms of languages, information summary and reflection of disclosure provided at product level. In this regard, it should be stressed once again that, according to the Luxembourgish law, the Luxembourg insurers may provide a range of IBIPs based on an open-architecture model. As already explained in point 1., the investment managers/investment fund issuers are responsible for providing the insurers with the sustainability disclosures mainly because they are the ones involved in the process of integrating sustainability risk(s) into investment decision making and assessing the likely impacts of sustainability risk(s) on investment returns. Therefore, the new provisions under art. 49a and 49f entail two relevant problems:

1) The new obligation to publish a "summary" (art. 49d and 49h) referred to the sustainability-related investment strategies requires the usage of data that the insurer does not normally manage and

process since, as already mentioned above, this analysis is carried out and provided by investment managers/investment fund issuers. However, the current wording used by the ESAs does not suggest any obligation in this sense on the investment manager/investment fund issuer and, therefore, would *de facto* result in an unsustainable burden on the insurers.

Proposed solution

The ESAs are invited to review the obligation related to the publication of the summary aiming at ensuring a level playing field also for the insurers with an open-architecture model.

2) The website disclosure obligations do not take into consideration the fact that the sustainability disclosure related to investment options is normally provided by investment managers/investment fund issuers who are normally reluctant and against the disclosure of such information on the insurers' website. In fact, although the regulatory obligation undoubtedly prevails over any contractual provision with these third parties, in cases where insurers are refused authorization for publication (especially when coming from extra-EU entities), they end up favouring the contractual relationship with the third party. Therefore, this may lead to the exclusion of the offer of the single investment option in order to avoid behaviours that may not comply with regulatory obligations.

Proposed solution

The ESAs are invited to review the general framework of the website disclosure obligations in the case of investment options whose information is provided by third parties in order to avoid that this misalignment could lead to a restriction of the offer of art. 8/9 investment options to clients.

3. Provisions related to periodic reports in case of MOPs

Periodicity of the reports

The RTS provisions require the financial market participants (FMP) to send to the customer a periodic sustainability report. The periodicity of the report is not the same for all financial products but depends on the deadlines that the relative sectorial regulations have set up for the various operators. In the case of Insurance Funds whose management is delegated to professional third parties, different FMPs with different deadlines are involved in the preparation of the periodic report. In particular, the insurance company has an annual reporting obligation which varies according to the country of distribution (for example in Italy, IVASS has set the deadline for insurance companies distributing unit-linked policies, to 31 May) while investment managers have a quarterly deadline in line with the obligations deriving from MiFID II.

As already mentioned in point 1. and 2., the insurance sector is dependent on the data provided by the investment managers/investment fund issuers and the evident misalignment between MiFID II and Solvency II regarding the timelines around the reporting obligations can result in an information mismatch that would harm the retail investors and ultimately result in the insurance sector not complying with the conduct of business provisions envisaged under art. 17 of the IDD, i.e. "[…] *when carrying out insurance distribution, insurance distributors always act honestly, fairly and professionally in accordance with the best interests of their customers*".

Proposed solution

The ESAs are invited to clarify how the deadlines of the different FMPs should meet.

Operational burden related to the transmission of the reports

In addition, there are many doubts in relation to the specific case of Internal Dedicated Funds (IDF). In particular, this type of investment support provides for the individual management of the insurance premium on the basis of an investment mandate set up by the manager.

As already widely explained above, in this case the insurance company does not independently draft the periodic report but, instead, receives it from the investment manager and then sends it to the related policyholder. However, this operational solution has raised considerable doubts in view of the non-unique procedure set up by the investment managers. In particular, while some investment managers have prepared a single reporting for all the portfolios managed in relation to a single investment mandate, the majority of investment managers have instead opted for a tailor-made solution for which the reports have been prepared on the basis of the single managed portfolio connected to the IDF.

As it is clearly understandable, the two different approaches determine a very different operational impact. Since the second approach has proved to be the preferred solution taken into account by investment managers, the insurance companies have been obliged to deal with a very high and increasing number of reports than initially budgeted. Although the high number of reports received does not represent *per se* a problem since the insurance company obligation is limited to the transmission to the policyholder, the real issues have arisen in relation to the modalities used for the procurement of the reports themselves. Quite interestingly, a large number of investment managers belonging to the same group as the custodian bank of the policy have not opted for paper or digital submission of the report but, instead, preferred to fulfil their reporting obligation by uploading the reports in digital format on the online banking system of the policy's bank account, often as part of the portfolio valuation statement.

For obvious reasons, the access to this online banking system is reserved to the insurance company being the holder of the account and cannot be shared with the policyholder. As a consequence, this is resulting in an onerous burden affecting the insurance industry which would need to deploy an internal function only dedicated to the analysis, management and process of data through the download of the reports from the online banking system of the bank accounts linked to the insurance policies.

Proposed solution

The ESAs are invited to review the obligation related to periodic reports aiming at ensuring a level playing field also for the insurers with an open-architecture model.

The above analysis clearly highlights that new obligations envisaged in the Joint Consultation Paper of the ESAs would therefore require insurance companies to put in place a substantial operational effort equivalent to that required for investment managers and other traditional FMPs which, however, already have internal risk, compliance and IT structures *a priori* capable of supporting these regulatory requirements.

Conclusion

In light of the above analysis, the insurance industry would like to stress that, in the event that the ESAs do not intend to consider the specific suggestions proposed, the new provisions related to MOP structures proposed in the consultation would appear to be incompatible with the interpretation that extends the qualification of insurance funds as financial products given the operational burden and the implementing issues to be borne by the insurance companies.

Therefore, if this would be the case, the ESAs are kindly invited to finally clarify the exclusion of the insurance funds from the financial products category and, at the same time, re-introduce, if deemed necessary, the provisions envisaged by the current version of RTS for MOP structures in case of art. 9 investment options that are not qualified as financial products (please refer to art. 20 par.3 (c)).

Alternatively, if the interpretation which provides for the extension of the obligations also in the case of insurance funds would be welcomed (therefore, expressly qualifying them as financial products), the ESAs are kindly invited to limit the application of the provisions analysed above only to the cases where the IBIP MOP offers investment options other than insurance funds (e.g. UCITS) and outline a more streamlined and adequate regulatory discipline in the case of insurance funds (especially when dedicated) as investment options.