

Consumer Protection Issues in the EU Unit-Linked Market

An overview of EIOPA's thematic review on monetary incentives and remuneration paid by asset managers to insurance undertakings

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Recently, the European Insurance and Occupational Pensions Authority (EIOPA) published a [thematic review on consumer protection issues observed in the EU unit-linked market](#). The report primarily focuses on potential conflicts of interest arising between providers of unit-linked products and consumers of such products, namely, as a result of monetary incentives and remuneration paid by asset managers to insurance undertakings. These payments, which typically take the form of “kickbacks” and commissions as a result of engaging in asset management services, could be seen to disadvantage consumers of unit-linked products.

Details of EIOPA's thematic review

- There were 776 insurance undertakings offering unit-linked products across EU member states at the end of 2015.
- The gross written unit-linked premiums for these entities totalled €277 billion during 2015.
- Total assets under management in respect of unit-linked business at the end of 2015 were €2,452 billion.
- The review covered around 70% of the overall EU unit-linked market, and concentrated on the main domestic undertakings in each member state.
- Seven Irish companies are noted as having taken part in the review, however they are not named.
- Ireland was ranked joint second in terms of unit-linked gross premium written in 2015 (€32 billion), alongside Italy and behind the UK (€112 billion). In terms of assets under management, Ireland was ranked third (€191 billion), behind the UK (€1,256 billion) and France (€290 billion).

Prevalence of monetary incentives and remuneration practices

- 81% of participating insurance undertakings received payments from asset managers in the form of monetary incentives and remuneration.
- The observed payments during 2015 totalled €3.7 billion which represented a median value of 0.56% of assets under management and 46% of total fund management charges paid to asset managers over the same period. (The 2015 estimate for the total market (i.e. allowing for undertakings that did not take part in the review) is €5.2 billion.)
- Less than 3% of unit-linked assets are managed directly by insurers; 69% of assets are managed by asset managers in the same group as insurers; yet the remaining 28% of

assets managed by external managers account for almost 50% of remuneration.

- Monetary payments were generally observed to be higher for actively managed funds, multi-asset funds, and managed funds invested in equities. Such funds are typically perceived as being of higher risk in nature.
- Such payments are predominately periodic in nature.

Acting in policyholders' best interests?

- Around 60% of participating insurance undertakings retain the monetary payments and do not share these with policyholders. Conversely, 25% of undertakings pass the full amount of monetary incentives to policyholders - which represent 30% of total monetary payments received in 2015.
- Around 70% of undertakings do not disclose these payments to policyholders in any form.
- Approximately 30% of participating insurance undertakings do not have formal internal processes in place for monitoring the performance of managed funds; in these instances the task is delegated to the asset managers. Similarly, 25% of participating undertakings do not have formal methods in place for selecting funds.
- Undertakings invest a significant proportion (around 60%) of unit-linked assets in the types of higher risk funds noted above paying higher amounts of remunerations and monetary incentives.
- While formal policies and governance were generally in place to ensure that undertakings acted in the best interest of policyholders, with specific reference to possible conflicts of interest, EIOPA observed that actual processes were not always consistent with what was articulated in these policies, and could vary materially.
- Similarly, the selection of asset managers in some cases was observed to be driven by existing relationships with asset managers. EIOPA also found that the selection process for asset managers did not always follow a comprehensive process.

'Potential consumer detriment' outlined in EIOPA's report

- The lack of disclosure around such payment mechanisms between asset managers and insurance undertakings may result in misinformed decisions by consumers when shopping around for products.

- Undertakings may not always provide the most relevant or competitive funds for policyholders if their selection criterion is based on those investment vehicles which pay the highest monetary incentives and remuneration.
- The existence of such payment mechanisms may also lead to higher costs for consumers.
- The limited offerings to consumers in terms of both the types of unit-linked funds and fund managers could result in products which are unsuitable, or lead to poor investment outcomes.
- The lack of comprehensive governance and controls in place with regards to selecting and monitoring asset managers and unit-linked funds is seen to be a further source of potential detriment to consumers.

Relevant local regulation in certain member states

- In Ireland, the Central Bank of Ireland's (CBI) Consumer Protection Code (2012) requires regulated undertakings to act in the best interests of customers and seek to avoid conflicts of interest.
- In Italy, regulatory provisions exist to ensure that policyholders benefit from any monetary payments and remuneration between insurance undertakings and asset managers. Undertakings are also required to identify instances where contractual agreements with third parties could generate a conflict of interest with policyholders.
- In Germany, prescriptive profit participation rules require undertakings to transfer a minimum of 50% of commission kickbacks and remuneration from asset managers to policyholders.
- In Belgium, undertakings are required to disclose details of monetary incentives and remuneration between insurance undertakings and asset managers. Regulation also specifies the types of monetary payments that are authorised.

Key takeaways from the report

- ✓ periodic monetary payments from asset managers to insurance undertakings are prevalent
- ✓ payments are material relative to the asset management charges paid by the insurance undertakings
- ✓ payments typically increase in magnitude with the riskiness of the underlying unit-linked fund offerings
- ✓ payments are not always disclosed to policyholders
- ✓ such payments could lead to higher indirect costs to consumers or could affect the range of unit-linked fund offerings

The report does not provide any detail in respect of observations within individual member states, so it is unclear to what extent such practices exist in Ireland. However, providers of unit-linked products in Ireland should consider whether such practices do exist within their undertakings, and assess whether appropriate governance and management processes are in place to mitigate the associated risks.

This is relevant in particular for Ireland as the CBI's Consumer Protection Code has provisions to ensure that undertakings act in the best interest of policyholders. Similarly, and not mentioned in the report, the Prudent Person Principle as per the Solvency II Directive requires undertakings to ensure that "*investment is made in the best interest of policy holders*", which may appear to contradict current practices, based on evidence from the EIOPA report.

Further to this, the CBI's latest approach to conduct and consumer protection risk, the Consumer Protection Risk Assessment (CPRA) model, is being used from 2017 onwards to carry out targeted assessments of regulated insurance undertakings. This may include an assessment of some of the themes discussed in this briefing note, such as treating consumers fairly and acting in their best interests. Hence, providers of unit-linked products need to be aware of their responsibilities in offering such products to consumers.

How Milliman can help

Milliman is a global thought leader on issues associated with financial, insurance and operational risk and has valuable insights into both domestic and international best practice

Our consultants have a wealth of expertise in consumer protection and conduct risk. We can assist undertakings with the following areas:

- Development and review of firms' consumer protection risk management frameworks
- Assisting firms in preparing for onsite CPRA inspections
- Drawing up a suitable consumer risk governance structure with assigned roles and responsibilities across the three 'lines of defence' as well as preparation of consumer protection policies and operational procedures
- Advising on the extraction and analysis of suitable management information related to consumer protection issues
- Assessment of the performance of risk management systems and procedures

For more information contact your usual Milliman contact or one of the contacts listed below.



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