European Protection of Retail Investors in Insurance-Based Investment Products: Product Interventions under PRIIPs[1]

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Abstract

The main goal of the Packaged Retail and Insurance-based Investment Products Regulation (PRIIPs) is to enhance investor protection standards for retail investors, in particular enabling them to better understand and compare the key features, risk, rewards and costs of different PRIIPs, through access to a short and consumer-friendly Key Information Document (KID). The regulation does not regulate advertisement information and does not aim to intervene in the measures associated with particular products otherways than in connection with the investment component. However, it contains authorisation for both EIOPA and the national regulators to set up remediation measures and restrict the distribution of particular products with investment component or particular types of financial activities. PRIIPs thus presents a kind of negative regulation of product development. The envisaged intervention mechanism is similar to those established in the framework of MiFID II and MiFIR. The authors mainly use the research methods of legal comparison, critical analysis, synthesis and deduction. The objective of the study is to clarify the impact of the above-mentioned rights of the regulatory bodies to the autonomy of will and the freedom of contract. The result of this study implies that the restrictive measures envisaged by PRIIPs may be applied only ultima ratio and are associated with private law liability.

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JEL Classification: G22, K20, K22, K23

1. Introduction

The Packaged Retail and Insurance-based Investment Products Regulation (hereinafter referred to as „PRIIPs regulation" or „Regulation")[4] has applied since 1 January 2018. The regulation lays down uniform rules on the format and content of the key information document to be drawn up by PRIIP manufacturers and on the provision of the key information document to retail investors to enable retail investors to

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[4] The full name of the PRIIPs regulation reads as follows: 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).

understand and compare the key features and risks of the PRIIP.[5]

The PRIIPs regulation entails a duty to draw up and a Key Information Document (KID), including a specific form and content of KID, and the requirements on provision of this document to the clients.[6]

The Chapter III of the Regulation is the utmost important part for the purpose of this paper, and it is called "Market Monitoring and Product Intervention Powers". It refers to Art. 9 section 5 of the Regulation (EU) No. 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority - EIOPA), hereinafter the "EIOPA regulation". Based on it, EIOPA is entitled to "*temporarily prohibit or restrict certain financial activities that threaten the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union in the cases specified and under the conditions laid down in the legislative acts referred to in Article 1(2) or if so required in the case of an emergency situation in accordance with and under the conditions laid down in Article 18."*[7]

The case is, that EIOPA regulation envisages only restriction or prohibition of *certain financial activities*, while PRIIPs regulation gives the authorities a right to prohibit or restrict not only a *type of financial activity or practice of an insurance or reinsurance undertaking* but also *certain insurance-based investment products*.

Based on the PRIIPs regulation, the right to prohibit or restrict the practices, activities and products described above may be exercised by EIOPA[8], but also by the regulator of a country, where the product is sold. Although the normative text of the PRIIPs regulation does not give a clear guideline on whether the home country or host country regulator should use product interventions,[9] according to the Recital 24 of the PRIIPs regulation, the regulator *"of the Member State where the product is marketed should always have the right to suspend the marketing of a PRIIP within their territory in cases of non-compliance with this Regulation."*[10] Nevertheless, the competent authority should properly consult competent authorities in other Member States that may be significantly affected by the action.[11] With no doubt, a home country regulator should be involved. Without being consulted, the applicability of such intervention to the affected branch of foreign insurer would be disputable.

However, a product intervention may only be applied if it addresses a significant investor protection concern, threat to the orderly functioning and integrity of financial markets and the stability of the whole or part of the financial system in the European Union or within at least one Member state.[12] The national regulators and EIOPA use the non-exhaustive list of criteria stated in Art. 1 of the Delegated Regulation (EU) 2016/1904 for identifying the products which raise significant investor protection

[5] PRIIPs regulation, Art. 1
[6] The Chapter II., and III of the PRIIPs regulation
[7] EIOPA Regulation, Art. 9 (5)
[8] PRIIPs regulation, Art. 16
[9] PRIIPs regulation, Art. 17
[10] PRIIPs regulation, Recital 24
[11] PRIIPs regulation, Art. 17 (2) d)
[12] PRIIPs regulation, Art. 16 (2) a) and Art. 17 (2) a).

concerns.[13]

This is possible only if the restrictive action is proportionate, does not have discriminatory effects, and the applicable regulatory requirements would not be better addressed by improved supervision or enforcement.[14] It implies that such an action may be taken only if any other public interventions may not lead or did not lead to the elimination of regulatory breach. This means that the product intervention represents an *ultima ratio* public intervention. However, making other "softer" public interventions is not a precondition for the application of the product intervention envisaged by PRIIPs regulation in case it is well justified as a necessary risk elimination/mitigation measure by the particular regulatory body. This opinion is in line with Colaert, who concludes that despite *"PRIIPs product intervention measures can be considered the keystone of the EU investor protection regime … a well-functioning product governance regime should make product intervention measures superfluous in the majority of circumstances.*"[15] Similarly, Colaert supports the idea of a restrictive approach towards product interventions suggested in this paper.

The framework of PRIIPs regulation follows the framework of setting similar harmonised standards for various financial products, which was already introduced by MiFID II/MiFIR.[16] However, some authors argue that such harmonised approach across various financial products does not solve the issue of the uninformed decision of customers. The statistical analysis shows performed by Paul et al. shows that customers are not satisfied with the new regulation of financial products, which may go against customer interests. Moreover, this new regulatory framework does not offer enough room for flexibility and customisation, and the implementation costs might offset any potential benefits.[17]

2. Impacts on product development and sales suitability

The manufacturers should, in the course of the product approval process under the POG regulation[18] ensure that the design of the insurance-based investment products may not (itself) cause problems with market integrity, represent a threat to the orderly

[13] 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

[14] Marcacci, A. Regulating investor protection under EU law: the unbridgeable gaps with the U.S. and the way forward. Cham: Palgrave Macmillan, 2018, Economics and finance collection, p. 67-68.

[15] Colaert V. *The MiFIR and PRIIPs Product Intervention Regime: In Need of Intervention?*. "European Company and Financial Law Review". De Gruyter. 2020. 17(1). pp. 99-124. accessed on 14 June 2021. The document is available online at: https://doi.org/10.1515/ecfr-2020-0004.

[16] Kern A. and Madders V. Financial market regulation in the internal market. In: Amtenbrink F., Herrmann Ch., and Repasi R.(eds.): *The EU Law of Economic and Monetary Union* Oxford: Oxford University Press. 2020. pp. 1089. accessed on 13 June 2021. The document is available online at: https://oxford.university pressscholarship.com/view/10.1093/oso/9780198793748.001.0001/isbn-9780198793748-book-part-44.

[17] Paul S., Schröder N., Schumacher S., *MiFID II/MiFIR/PRIIPs Regulation Impact Study: Effectiveness and Efficiency of New Regulations in the Context of Investor and Consumer Protection. A qualitative/empirical analysis.* Final report. German Banking Industry Committee, 2019, accessed on 3 June 2021. The document is available online at: https://die-dk.de/media/files/Auswirkungsstudie_MiFID_II_ Prof_Paul.pdf.

[18] 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.

functioning or stability of the financial market[19] or represent an investor protection concern. The latter component of this "viability triad" has strong consequences with the Key Information Documents associated with proper identification of target market[20] and with an assessment of suitability and appropriateness of the individual customer.[21] While the target market is linked to a generic group of compatible customers for whom the product is suitable, assessment of suitability needs to reflect the requirements and needs of a particular customer.

Manufacturers of the products shall only design and market insurance products that are compatible with the needs, characteristics and objectives of the customers belonging to the target market and may define, in particular with regard to insurance-based investment products, groups of customers for whose needs, characteristics and objectives the insurance product is generally not compatible.[22] They shall also assess whether the insurance products remain consistent with the target market and whether the products are distributed to the target market or is reaching customers outside the target market,[23] which is, however, not prohibited. It is possible to sell the insurance product outside the target market under the condition that based on individual analysis, proper advice and justification, the product (and specific features chosen by the customer) has been assessed as suitable for the particular customer, or the customer insisted on it. For example, if the product is aimed at people with high income, also a person with low income can purchase it if it was assessed as suitable by the distributor (taking into consideration the particular life situation of the client) or if the client wanted such product disrespecting the distributor's advice.[24]

Although neither Article 17 nor Article 16 of the PRIIPs regulation expressly prohibits specific types of remuneration or bonuses, it implies the need also to review the remuneration policies and ensure that they do not contain incentives that are likely to enhance mis-selling.[25]

It can be concluded that proper product oversight and governance (that is applicable also for existing products), suitability of sales and all-over transparency and appropriateness of both pre-contractual and contractual documents may play the fundamental role in this topic and protect the insurer from the regulatory actions envisaged by PRIIPs regulation. On the other hand, it might be argued that the increased protection of retail investors under the PRIIPs regulation can slow down the innovations and product development, as PRIIPs manufacturers have to fulfil the obligation arising from tightening regulation.[26]

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[19] Marano, P., Rokas, I., *Distribution of Insurance-Based Investment Products*. Cham: Springer Nature Switzerland AG, 2019, p. 73-74.

[20] POG regulation, Art. 5.

[21] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution, Art. 30.

[22] POG regulation, Art. 5.

[23] POG regulation, Art. 7(1).

[24] IDD Directive, Art. 2(15).

[25] Chrissanthis, Ch., *Transparency in the Insurance Contract. Law of Greece* in Marano, P., Noussia K. (eds.), *Transparency in Insurance Contract Law*. Cham: Springer Nature Switzerland AG, 2019, p. 124.

[26] Tomic, K. *Product Intervention of Supervisory Authorities in Financial Services*. In: Grima, S. and Marano, P. (eds.) *Governance and Regulations' Contemporary Issues (Contemporary Studies in Economic and Financial Analysis, Vol. 99)*, Bingley: Emerald Publishing Limited. pp. 229-255. accessed on 10 June 2021, The document is available online at: https://doi.org/10.1108/S1569-375920180000099011.

2.1. Polish regulator's action and EIOPA's reaction

The Polish Financial Supervision Authority (KNF[27]) decided to present a "project on product intervention" in relation to unit-linked products offered in the Polish market, based on Article 17 of the PRIIPs regulation.[28] It means that the KNF prepared a set of intervention measures presenting a systematic mechanism of Art. 17 application aiming at product profitability, investment limitations and disclosures of fees and commissions. These measures apply only to new unit-linked products and count on the prohibition of marketing, distribution and selling of such products if:

a) the minimum return rate of each fund in the recommended product holding period is lower than a certain rate,

b) the costs of the fund for the client exceed a certain threshold,

c) the unit-linked funds invest in assets not allowed for UCITS funds, especially to assets with either high-risk, low liquidity or limited transferability (closed-end investment certificates) or

d) the product documentation does not include clear information about fees associated with the product, or the fees are not easy to calculate.

2.2. Information needs to be in any case delivered to the client regarding kickbacks

The calculations (not based on PRIIPs methodology) associated with the above-mentioned measures should be performed by the insurance company in the product design phase and on the occasion of annual reviews of such products.

The KNF has informed EIOPA of a proposed product intervention measures with the reasoning that they have identified risks for policyholders buying unit-linked insurance products in Poland.

EIOPA already issued an opinion on these product intervention measures[29] where it has highlighted concerns with some unit-linked life insurance products and has identified the emergence of similar value for money risks to those highlighted by KNF in the wider European market. Although they admitted that there are significant investor protection concerns and targeted product intervention measures may be justified in the interest of consistent and timely action, it was concluded that the proposed product intervention measures interfere with the fundamental rights and freedoms of insurance undertakings and are not justified or proportionate for tackling concerns with the type of investments offered or the transparency of fees and commissions.

EIOPA also concluded that The KNF has no power under national law to issue any binding legal regulation to the insurance sector. KNF should further explore the use of other regulatory or supervisory measures, including the introduction of additional requirements in national legislation. EIOPA is only required to adopt and publish an

[27] Komisja nadzoru finansowego (Finance oversight commission).

[28] Insurance Europe. Unit-linked product intervention (PL update). Memo for information.

[29] EIOPA. Opinion of the European Insurance and Occupational Pensions Authority on the proposed product intervention measure of Komisja Nadzoru Finansowego of Poland. 2021, accessed on 15 June 2021, The document is available online at: https://www.eiopa.europa.eu/content/opinion-of-european-insurance-and-occupational-pensions-authority-proposed-product_en.

opinion[30] on whether a planned product intervention by a national competent authority is justified and proportionate. If EIOPA considers that taking measures by other competent authorities is necessary to address the risk, it must be stated in the opinion, which is formulated on the basis of the information provided by the relevant national authority, including details on the nature of the risk, supportive evidence and the scope and nature of intended product intervention measure.[31] However, the opinion of EIOPA is not binding. The national regulators are entitled to take action contrary to it[32] and are only required to publish the properly justified reasons on their website.

2.3. Value for money

EIOPA repeatedly highlighted concerns that costs for some unit-linked products continue to remain too high and is therefore seeking for "a market where consumers can be confident that the products on sale offer good value for money." Also, in connection with the KNF action commented above, EIOPA launched a public consultation on measures addressing value for money risks to ensure good outcomes for the consumers in the European unit-linked market.[33] EIOPA is persuaded that such concerns have been heightened by the COVID-19 crisis and the low-interest-rate environment coupled to market shocks that may result in the need for increased access to liquidity from the households. It implies that the value of unit-linked products should be measured by potential satisfaction of the need for liquidity.

EIOPA is persuaded that consumer outcomes must be put "at the heart of product design," distribution and monitoring processes to tackle the value for money issues. The main principles of the mentioned concept are:

- „Value offered by unit-linked (and hybrid) products should be assessed both are taking into account the product as a whole as well as each product component (investment, insurance and guarantees, if any).

- When products are tested, manufacturers should assess the product features and characteristics, including costs and the reward profile of the products, vis-à-vis the target market characteristics, objectives and needs, and they should ensure that no 'undue' costs are charged to consumers.

- Products which are difficult for consumers to understand should have more granular target markets and adequate measures in place to mitigate complexity related risks."[34]

Based on those "three pillars," a certain set of tools should be developed for the insurers and regulatory bodies to assess whether the costs are undue. It should also

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[30] PRIIPs regulation, Art. 18(2).

[31] EIOPA. EIOPA partially supports a planned prohibition of some unit-linked life insurance products by the Polish Financial Supervision Authority and calls for coordinated action across Europe. 2021, accessed on 15 June 2021. The document is available online at: https://www.eiopa.europa.eu/content/eiopa-partially-supports-planned-prohibition-of-some-unit-linked-life-insurance-products_en.

[32] PRIIPs regulation, Art. 18 (3).

[33] EIOPA. EIOPA consults on a framework to address value for money risk in the European unit-linked market. 2021. accessed on 16 June 2021. The document is available online at: https://www.eiopa.europa.eu/. content/eiopa-consults-framework-address-value-money-risk-european-unit-linked-market_en.

[34] EIOPA. EIOPA consults on framework to address value for money risk in the European unit-linked market. 2021. accessed on 16 June 2021. The document is available online at: https://www.eiopa.europa.eu/ content/eiopa-consults-framework-address-value-money-risk-european-unit-linked-market_en.

comprise the value for money "testing methods" together with practical benchmarks.

EIOPA also mentioned that although the value for money concept is not included in EU legislation, the POG framework highlights that product characteristics, including costs "need to be tested to ensure they are aligned to the target market's needs, objectives and characteristics, which also includes the target market's ability to pay and bear losses." However, there is no explicit mention of the target market's ability to pay and bear losses in POG regulation, so it is unclear to which provision this statement refers to. EIOPA further declared a "need for more harmonised guidance to implement POG requirements and address consumer detriment arising from products where the costs and charges are not proportionate to the benefits and hence where products do not offer value to the target market."

The latter prediction may indicate that this initiative may result in the issuance of specific regulatory technical standards on POG regulation. The public consultation is based on a questionnaire containing specific questions.[35]

The opinion of the authors is that measuring the value of unit-linked products by liquidity is the wrong way. Unit-linked products represent investment-linked plans being generally regarded as long-term insurance plans. Therefore, the inherent liquidity of such products is inherently low and premature termination in the early years of the contract may lead to absolute loss of value. Even later, when the customer becomes entitled to the surrender value, the termination of the contract will not result in profits. Unit-linked insurance is profitable only in the long-term horizon, both for the customer and the insurer. It does not pay off in the short-term horizon, and the value for the customer is low. Although the matter of liquidity is mentioned in the introduction of the "call for consultations," it is not mentioned in the questionnaire.

When it comes to profitability, the main issue is that unit-linked insurance is profitable mainly for the insurance intermediaries, although clawbacks in the first years of the insurance may apply based on certain national laws. Insurance-based products are combining retail investments packaged with life insurance policies under insurance contracts. They are offering a maturity/surrender value exposed, partially or as a whole, to market fluctuations.[36] Despite the fact that profits and losses of customers depend on the market fluctuations, the remuneration of the intermediaries does not. Moreover, the undue costs associated with unit-linked insurance are obviously caused by the disproportional remuneration of the intermediaries. In order to treat this market deformity, commissions may be limited by a certain percentage of yearly premium or tying the remuneration to the profits of the policy may be considered. Remuneration of intermediaries is completely omitted in the consultation material and questionnaire.

The question is how the value for money considerations can improve the value of unit-linked products and what should be the methods of testing. It is predictable that the main value-related issue will be represented by the commissions. If a single insurer decides to decrease the remuneration of intermediaries, they will probably turn to competitors. Therefore, it implies that the only solution may consist of the regulatory limitations of commissions.

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[35] EIOPA. EIOPA Public Consultation on 'Framework to address value for money risk in the European unit-linked market'. 2021. accessed on 17 June 2021. The document is available online at: https://ec.europa.eu/eusurvey/runner/EIOPA_Public_Consultation_ULM.

[36] PRIIPs regulation, Art. 4 (2).

3. Conclusion

Although the subject matter of the PRIIPs regulation is the content of Key Information Document limited to the provision of pre-contractual information to the customers, it contains the empowerment of national authorities to apply product intervention measures with reference to EIOPA regulation although the latter one entrusts this power exclusively to EIOPA. Moreover, the national regulator may enforce its decision despite the dissenting opinion of the European regulator. The restriction of business activity by the intervention of public authorities results in the interference with the private law relations realised on the grounds of autonomy of the will. The above-discussed conditions of product interventions are not set up exactly enough by the PRIIPs regulation to be applied regardless of the applicable provisions of national law. It also needs to be considered that although the consumer-protection rules will apply in most cases, not all unprofessional customers are consumers.

It may be concluded that if the intervention measures (of both European and national regulator) will not be proportionate and will cause the restriction of sales of the certain product whose features are compliant to the binding provisions of applicable national law, the liability for damage (incl. lost profits) will apply. Therefore, the affected authority should thoroughly examine if the features of certain products they are going to restrict are compliant with local law or not. It even needs to be differed, if the breach of rules was caused by the product itself or just by certain ways of distribution. Banning the product only due to improper distribution may still result in liability, especially when distributed via various sales channels (for example, tied vs independent agents). It implies that the application of this negative regulation of product development and distribution may be applied only ultima ratio, and also, the questions associated with private law liability need to be replied to before the action is taken.

When it comes to the "value for money" issue, the practical questions reflecting market standards and usages must be considered because neither the customer nor the insurer is the one who significantly benefits from the insurance-based investment products. Their value is mostly consumed by the intermediaries while the customers and insurers profit only from a long-time perspective. Therefore, the limitation of intermediaries' commissions should become the crucial part of the value for money considerations.

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