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Position of the Polish Financial Supervision Authority on the presentation of fees in unit-linked life insurance contracts

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A unit-linked life insurance contract (hereinafter also: ‘unit-linked insurance contract’) is a specific form of insurance contract which combines insurance coverage, characteristic of insurance understood in its traditional sense, with savings and investment. Under the contract, an insurance undertaking pledges to pay a benefit in the event of the insured’s death or where the insured is alive at the end of the policy term, and to invest, at the client’s risk, the assets from insurance premiums accumulated in the unit-linked fund, and the client pledges to pay the insurance premium. Thus, such a contract combines coverage with the accumulation of capital.

A unit-linked insurance contract is highly complex and, therefore, it is difficult for clients to understand its structure and, most of all, the related risks. In particular, the complexity of a unit-linked insurance contract consists in the way the provisions of the contract are formulated in regard to the related fees the client undertakes to pay. That was noted by the legislator, who, in Article 23 of the Act of 11 September 2015 on the business of insurance and reinsurance (consolidated text in: Polish Journal of Laws 2021, item 1130, as amended, hereinafter: ‘Act on the business of insurance’), indicated the mandatory elements of the contract, including, under Article 23(1) point 5 of the Act on the business of insurance: the details and amounts of the fees deducted from insurance premiums, from the assets of unit-linked funds or through redemption of participation units in unit-linked funds. In the legislator’s view, due to the significant complexity of the contract, the client should be provided with full information about the related fees. However, the legislator left insurance undertakings broad discretion to determine the details of the fees collected. In fact as regards the fees, a unit-linked insurance contract is designed mainly under the freedom of contract. However, in reality, the form of the contract is determined mainly by the insurance undertaking, since a unit-linked insurance contract is an adhesion contract, which, in general, is non-negotiable. In fact, it should be pointed out that the complexity and poor transparency of provisions of unit-linked insurance contracts in terms of description of fees results from, among others, the manner in which insurance undertakings present such information, and such manner being inconsistent and preventing the comparison of various contracts. Studies on consumer awareness show that in the Polish insurance market, consumers usually do not have a good understanding of how unit-linked insurance contracts work¹.

The work to prepare the decision on the prohibitions on the marketing, distribution and sale of insurance-based investment products – unit-linked life insurance contracts (hereinafter: ‘decision on the intervention measure’)² involved an assessment of provisions of unit-linked insurance contracts offered on the Polish market in 2019–2020. The assessment identified elements of the descriptions of fees which reduce transparency of those descriptions.

¹ E.g. Report *Nieprawidłowości na rynku finansowym a ochrona konsumenta* [Irregularities in financial market vs consumer protection], issued on 24 September 2019 by the Advisory Scientific Committee of the Financial Ombudsman.

² Decision of the KNF Board of 15 July 2021 (Ref. No DNM-DNMZWP.6065.79.2021) on the prohibitions on the marketing, distribution and sale of insurance-based investment products – unit-linked life insurance contracts.

The available unit-linked insurance contracts provide for many types of fees, often with a complex, non-transparent structure and in various amounts. They may be collected as a fixed amount or percentage of the insurance premium, assets of the unit-linked fund or benefits. Moreover, insurance undertakings not always make it clear whether the list of fees under the unit-linked insurance contracts is exhaustive.

That in practice prevents an average client from understanding how unit-linked insurance contracts actually work and from making an informed choice about whether to enter into such a contract on the terms offered by the insurance undertaking or not. In the opinion of the Polish Financial Supervision Authority (hereinafter: 'UKNF'), the above-described manner of designing a unit-linked insurance contract in terms of fees fails to ensure an appropriate level of client protection, which translates into, in particular, the actual or possible infringement of the interests of the policyholders and the insured.

Therefore, in its communication of 15 July 2021 announcing the decision on the intervention measure, the KNF Board pointed to the need to enhance client protection in the area of unit-linked insurance contracts, including with regard to the inclusion of fees in such contracts. Due to the need to provide proper client protection, it is important that unit-linked insurance contracts are designed so as to ensure a transparent and unambiguous description of the fees the client is required to pay in relation with entering into such a contract.

Therefore, considering the objective of financial market supervision defined in Article 2 of the Act of 21 July 2006 on financial market supervision (Journal of Laws 2020, item 2059, as amended) as ensuring the proper functioning, stability, security and transparency of, and the confidence in, the financial market, as well as ensuring protection of the interests of market participants, including through the provision of reliable information concerning its functioning, the UKNF below expresses its expectations as to the presentation (description) of fees under a unit-linked insurance contract. In the UKNF's view, if insurance undertakings meet the expectations, that will increase the transparency and clarity of the contracts, which will in turn increase client protection and confidence in the insurance market and the financial market as a whole.

The UKNF is of the view that the insurers' practice of concluding unit-linked insurance contracts showing the features regarding the description of fees as described below³ means that they carry on their business to the detriment of the interests of the policyholders and the insured:

- 1. The unit-linked insurance contract does not contain information that the fees⁴ thereunder are collected separately by the insurance undertaking and the investment**

³ The term 'fees' used in this Position should be understood, regardless of their names, as the fees, commissions and any other charges deducted from insurance premiums, from the assets of the unit-linked fund or through the redemption of participation units in the unit-linked fund.

⁴ In unit-linked insurance contracts, also referred to as remuneration.

fund management company, or the information about the fees collected by the investment fund management company is incomplete.

Under a unit-linked insurance contract, the insurance undertaking usually collects fees to cover the costs related with investing the assets from insurance premiums in participation units in unit-linked funds. Under the unit-linked insurance contracts under which the assets from insurance premiums are invested in the unit-linked funds whose assets are invested in investment funds managed by an investment fund management company, the investment fund management company also collects fees, independently from the insurance undertaking. The economic burden of those fees is actually on the client of the insurance undertaking, as the fees are charged to the assets from insurance premiums.

The UKNF's analytical exercises have revealed the occurrence of unit-linked insurance contracts which fail to provide information about the fees actually paid from the client's insurance premiums. The assessments have also shown that in some unit-linked insurance contracts, the information about the fees was incomplete: the existence of the fees was mentioned but without specifying whether the fees were collected only by the insurance undertaking, or also by the investment fund management company.

In the UKNF's opinion, that means that the information about the fees collected by the investment fund management company is communicated in a non-transparent manner, which is an indication of harm to the interests of the policyholders and the insured. As a result of unit-linked insurance contracts containing such non-transparent information, the policyholder and the insured are not fully informed about the fees collected from the sums of money they paid.

2. As regards the amount of the fees collected by the investment fund management company, the unit-linked insurance contract includes references to websites that do not provide such information.

As regards the disclosure of information about the amounts of the fees collected by investment fund management companies in unit-linked insurance contracts, insurance undertakings use the practice of referring to their websites, the websites of the investment fund management companies that manage the assets of the unit-linked funds under the contract, or the websites of the group of companies the insurance undertaking and the investment fund management company are part of. However, the UKNF's studies have shown that finding the information about the amounts of the fees collected by investment fund management companies on those websites was difficult or impossible. Some of the websites indicated by insurance undertakings in unit-linked insurance contracts did not contain any information about the current amount of the fees at all.

In the cases described above, the client cannot get, directly and immediately, the full information about the amounts of the fees collected by the investment fund management company. Moreover, due to the above-described design of a unit-linked insurance

contract in terms of information about the fees, the client is not provided with current information about changes in those fees. In order to get such information, the client must be very active – in particular, not only do they need to find the relevant website containing such information but, most of all, they need to have the knowledge, also in the area of capital market, to be able to find and regularly search the relevant information on the fees collected by the investment fund management company.

Therefore, the above-described practice does not ensure sufficient transparency on the rules for disclosing the fees, in particular considering their various levels, which is an indication of harm to the interests of the policyholders and the insured. As a result of the above-mentioned practice, the policyholder and the insured do not have the full up-to-date information about the amount of the fees they have to pay.

3. The contract does not contain information that the insurance undertaking receives from the investment fund management company remuneration for investing the money from insurance premiums being the company’s assets in investment funds managed by the company, where the insurance undertaking collects such remuneration.

At the turn of 2019 and 2020, the UKNF conducted a study on the occurrence of an investment premium⁵ in the unit-linked insurance market. The study has shown that out of 33 unit-linked insurance contracts under assessment:

- for 27 contracts – the undertakings offering the contracts received a ‘kick-back’ investment premium⁶ from the investment fund management company,
- for the other 6 cases – the insurance undertakings did not receive the investment premium.

It should also be noted that the insurance undertakings that confirmed they received the investment premium did not provide such information in the unit-linked insurance contracts. In the UKNF’s opinion, due to the failure to provide, in a unit-linked insurance contract, the information that the insurance undertaking receives a ‘kick-back’ investment premium, the client does not have the information which is important for the client’s interests.

It should be noted that in the case in question, the remuneration paid by the investment fund management company to the insurance undertaking from the fees collected by the company from the company’s assets acquired from the money entrusted by the client to the insurance undertaking (insurance premiums) is an additional cost item, not disclosed

⁵ An analysis carried out by the UKNF based on the information submitted by selected insurance undertakings jointly holding a 93% share in the domestic market of insurance products referred to in Division I Class 3 of the Annex to the Act on the business of insurance.

⁶ ‘Kick-back’ investment premium is any type of payment received by an insurance undertaking from an investment fund management company for investing the money from insurance premiums being the company’s assets in investment funds managed by that company.

in the unit-linked insurance contract. Due to the failure to provide, in the unit-linked insurance contract, the information about the investment premium being applied, the client is not aware of the fact that such payment for the insurance undertaking reduces the value of the assets which come from the insurance premiums the client pays.

Therefore, the above-described practice does not ensure sufficient transparency in terms of providing the client with information on the financial charges determining the value of assets being the basis for the payment of benefits under the unit-linked contract, which is an indication of harm to the interests of the policyholders and the insured.

4. The elements determining the final value of the fees are defined in the unit-linked insurance contract only by reference to the general rules, as laid down in the acts of universal law.

The UKNF identified unit-linked insurance contracts in which the fees were described using terms not defined in the contract, with a reference to definitions of such terms included in the acts of universal law (for example civil law). In such a case the client cannot calculate the final amount of the fees directly, based on the provisions of the unit-linked insurance contract, but they need to search for the relevant definition in other, often imprecise, legal regulations. Such design of the fee provided for in a unit-linked insurance contract creates a situation where the client, in order to figure out the current amount of the fees, must know the relevant provisions of universal law to which the contract refers, or must be able to find them and apply them properly. Meanwhile, it should be noted that in order to understand the content of a unit-linked insurance contract, the client should not have to know specific provisions of law.

In view of the foregoing, the UKNF has concluded that the descriptions of fees provided in a unit-linked insurance contract and making a reference to the terms defined in the acts of universal law show low transparency and generate a high risk that the client might not understand the information regarding the final amount of the fees the client will be required to pay, which is an indication of harm to the interests of the policyholders and the insured.

5. The contractual provisions defining what type of fees an insurance undertaking may collect contain terms which are not defined or which are formulated in a way that makes it impossible to find out for what acts performed by the insurance undertaking or at what dates and in what circumstances a given fee is collected.

In their unit-linked insurance contracts, insurance undertakings describe the grounds for collecting fees using terms which are not defined in the contract. In addition, in some unit-linked insurance contracts, the descriptions of the fees are not precisely formulated and may refer to all kinds of different acts performed by the insurance undertaking. In those cases, the client cannot be certain for what act specifically they are required to pay.

In the UKNF's view, an imprecise or ambiguous description of the grounds for collecting the fees causes the unit-linked insurance contract to be non-transparent with regard to the scope in question, which is an indication of harm to the interests of the policyholders and the insured. In fact, in such a situation the client does not have full information as to the actual grounds on which they pay the fee.

6. Failure to specify, in a unit-linked insurance contract, the circumstances in which the insurance undertaking may index the fees.

Some unit-linked insurance contracts used in the market provide for an indexation (adjustment) of the fees without listing all the circumstances in which fee indexation may take place. The contractual provisions concerning the rules for fee indexation contained, in particular, references to provisions of universal law regarding the insurance, investment or financial activities that may cause a change to the amount of the fees, or pointed to other general and unspecified circumstances (e.g. a change in the interpretation of laws), thus preventing the client from easily identifying situations where such indexation may take place.

That causes the unit-linked insurance contract to be non-transparent with regard to the scope in question, which is an indication of harm to the interests of the policyholders and the insured. As a result of the above-mentioned practice, the policyholder and the insured do not have the full up-to-date information on specific circumstances in which the amount of the fees they are required to pay may increase.

7. The table of fees, forming part of a unit-linked insurance contract, does not list all the fees indicated in the general terms and conditions of insurance.

The UKNF also identified the occurrence of unit-linked insurance contracts that indicated what type of fees the client is to pay but failed to list all the fees in the table of fees forming an appendix to the insurance contract. Meanwhile, in the UKNF's view, the main function of the table of fees, as an important element of a unit-linked insurance contract, should be to provide the client with complete and unambiguous information about all the fees the client is required to pay under the contract.

If incomplete, such information makes the unit-linked insurance contract non-transparent and potentially misleading. That indicates an infringement of the interests of the policyholders and the insured as in such a situation they do not have full understanding of the fees they will actually be paying under the contract.

8. The index provided in the general terms and conditions of insurance, in accordance with Article 17 of the Act on the business of insurance, in the section on costs and any other charges deducted from insurance premiums from the assets of the unit-linked investment fund or the redemption of participation units in the unit-linked fund, does not contain a precise reference to the contractual provisions which specify such costs or other charges, i.e. it fails to indicate the last level of the multi-tier numbering system.

The market offers unit-linked insurance contracts in which the information indicating which provisions specify the costs and other charges deducted from insurance premiums, from the assets of the unit-linked fund or through the redemption of units in the unit-linked fund (the so-called index⁷) was drawn up imprecisely. In particular, cases of contracts were identified where the index only indicated the main subdivision relating to more than one contractual provisions (e.g. a paragraph composed of several points) but failed to indicate the lowest subdivision, which regulated the costs or charges.

Such method of presenting, in the index, the provisions of a unit-linked insurance contract which specify the costs and other charges is incomplete and may prevent the client from fully understanding the fees defined in the unit-linked insurance contract, which is an indication of harm to the interests of the policyholders and the insured.

9. Where the amount of the fees under a unit-linked insurance contract is calculated using mathematical terms and formulas (including those used in financial mathematics), the contract fails to provide an example illustrating how to calculate the fees using those terms and formulas.

The UKNF's analyses have shown that in their unit-linked insurance contracts, insurance undertakings tended to present the calculation of a given fee by means of a formula in which the client should enter values by themselves if they wanted to know the final amount of the fee. However, it should be noted that the formulas presented in the contracts contain many complicated elements, which may make it difficult (or even impossible) for an average client to calculate the fee correctly.

An example are the provisions of unit-linked insurance contracts concerning the fees on account of the risk of death, collected from the unit account. The table of fees provided in unit-linked insurance contracts contains annual rates of the fees for the risk, which rates depend on the age of the insured. Those rates are used to calculate the amount of the fees for the risk to be collected from the unit account of the unit-linked fund. However, the method of calculating the fee for the risk was not presented using an appropriate formula or an example of calculation. In order to make a correct calculation, one needs to know and apply other parameters, such as: the insurance sum and/or the number of units in the unit-linked fund held, and their prices as at the date of the calculation.

In the opinion of the UKNF, an average client cannot reconstruct the calculations made to determine the amount of the fee as at a specified date. Such design of unit-linked insurance contracts proves such contracts to be non-transparent, which is an indication of harm to the interests of the policyholders and the insured.

⁷ In accordance with Article 17(1) point 3 of the Act on the business of insurance, the contract templates used by insurance undertakings, in particular the general terms and conditions of insurance, shall contain information indicating which provisions specify the costs and all other charges deducted from insurance premiums, from the assets of unit-linked funds or through redemption of participation units in unit-linked funds.

The UKNF expects that insurance undertakings will take measures to ensure transparency of information on fees in unit-linked insurance contracts, in particular to the extent covered in this Position.

The analysis of compliance by insurance undertakings with this Position and, if necessary, their further adjustment thereto based on the results of the analysis should be a process involving the undertakings' units operating on the first line of defence, e.g. units responsible for insurance products, as well as units operating on the second line of defence, including in particular the compliance function; the analysis should be carried out through appropriate reviews and assessments. It is also appropriate that internal audit, as the third line of defence, should review the assessment of risk and adequacy of the measures taken by the units on the first and second lines of defence.

The UKNF expects the unit-linked insurance contracts to be offered as of 1 June 2022 to comply with this Position.

At the same time, the UKNF would like to announce that the method used by insurance undertakings to present the fees in their unit-linked insurance contracts is to be reviewed as part of on-site and off-site supervisory activities.

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