



Position of the UKNF
on the adaptation of activities of insurance undertakings to the requirements
of the decision of 15 July 2021 (DNM-DNMZWP.6065.79.2021) on the
prohibitions on the marketing, distribution and sale of
investment products – unit – linked life insurance contracts

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In this Position, the UKNF sets out its expectations regarding the essential aspects of governance related with the obligation of insurance undertakings to ensure, and to perform tests and analyses to verify, compliance with the requirements of the Decision. This Position also addresses the issues of interpretation raised by insurance undertakings.

SCOPE OF THE DECISION

On 15 July 2021, the KNF Board [Komisja Nadzoru Finansowego] issued a decision (DNM-DNMZWP.6065.79.2021, hereinafter: 'Decision') imposing prohibitions on the marketing, distribution and sale of insurance-based investment products – unit-linked life insurance contracts (hereinafter: 'unit-linked insurance contracts' or 'product') for which:

- the average return is less than 50% of the interest rate for the period specified in the Decision according to the appropriate risk-free interest rate term structure (the prohibition specified in point I.1 of the operative part of the Decision);

or

- the investment rules and restrictions defined in the regulations of the unit-linked fund fail to ensure that the assets of the unit-linked fund will not be invested in contingent convertible instruments (CoCos)¹ (the prohibition specified in point I.2 of the operative part of the Decision).

The Decision applies:

- in the territory of Poland, which means that insurance undertakings, regardless of the place of their head office and country from which they operate, must comply with the Decision if they provide services to clients having their head office or habitual residence in the territory of Poland;

and

¹ According to point I.7 of the Decision, contingent convertible instruments mean contingent convertible bonds, subordinated loans and/or other instruments and contracts under which in the case of occurrence of a trigger event defined in the terms of issue or contract, the issuer or debtor cancels the instruments/contracts, by way of a write-down or temporary write-down of the principal amount of the instrument or liability in whole or in part, or converts the instruments/contracts into shares, or cancels the interest, in whole or in part, for the relevant interest period or suspends the interest payments for an indefinite period, if such contingent convertible bonds, subordinated loans, instruments are issued, or such contracts are concluded, by the debtor to qualify them, or if they have been qualified, as:

(a) elements of own funds under Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176 of 27 June 2013, p. 1, as amended), or

(b) own funds under Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 12 of 17 January 2015, p. 1, as amended).

- from the territory of Poland, which means that insurance undertakings having their head office in the territory of Poland must comply with the Decision if they provide services to clients having their head office or habitual residence outside the territory of Poland.

The Decision comes into effect on 1 January 2022 and applies to all contracts concluded on or after that date, regardless of the point of time at which the process of offering the product started.

The responsibility for pursuing business in accordance with the requirements laid down in the Decision lies with insurance undertakings, which should take a series of actions to that end, both before and after the Decision comes into effect.

It is important for insurance undertakings to verify compliance of the unit-linked insurance contracts they market, distribute or sell with the requirements of the Decision, and such verification should be part of the product management and product governance processes, with key functions being incorporated in those processes.

The expectations of the supervisory authority set out below constitute minimum expectations, rather than an exhaustive list of expectations. The measures taken by insurance undertakings should be adapted to the specific nature of their business and it is therefore appropriate for insurance undertakings to adopt measures which go beyond the aspects outlined below.

1. SYSTEM OF GOVERNANCE

The supervisory authority considers it appropriate to indicate detailed tasks in the area of system of governance aimed at ensuring compliance of the business of an insurance undertaking with the Decision.

SUPERVISORY BOARD

1.1 The supervisory board of an insurance undertaking should receive from the management board information which allows for the assessment of implementation by the insurance undertaking of the requirements laid down in the Decision, and the scope and frequency of reporting should depend on the scale of the undertaking's business in the area of unit-linked insurance contracts and on the level of risks identified.

1.2 As part of its supervision, the supervisory board of the insurance undertaking should consider the level of adaptation of the insurance undertaking to the Decision in its annual report containing the results of the review of the management or directors' reports referred to in Article 382 § 3 of the Commercial Companies and Partnerships Code.

MANAGEMENT BOARD

1.3 The management board of an insurance undertaking should ensure the effective implementation of the Decision in the undertaking's organisational structure, in particular it should undertake the necessary activities to identify, measure, monitor and manage the risks associated with possible existence of the products prohibited under the Decision in its offer.

1.4 The management board of the insurance undertaking should regularly monitor the current situation in terms of adaptation of the offer of products to the requirements of the Decision, in particular it should review the reports containing information on the risks identified in the business processes (areas) to which the Decision applies.

1.5 The management board of the insurance undertaking should involve other key functions or key functions holders' and competent organisational units established in the undertaking in the process of assessing the adaptation of the undertaking's offer of products to the requirements of the Decision. The participation of such functions/organisational units in the process should be properly recorded.

1.6 The management board of the insurance undertaking should include, in the undertaking's annual report, the assessment of the level of adaptation of the offer of products to the requirements of the Decision. The report for 2021 should also include the assessment of preparations for the implementation of the Decision.

COMMITTEES

1.7 The reporting to the insurance undertaking's committees, particularly to: the audit committee, the investment committee, and the risk management committee, should consider the management report on the implementation of the requirements laid down in the Decision. The management report should include an assessment of, *inter alia*:

- the adaptation of the undertaking's offer of products to the requirements of the Decision, and
- the level of risks in that area.

DISTRIBUTION OF TASKS WITHIN THE ORGANISATIONAL STRUCTURE OF AN INSURANCE UNDERTAKING

1.8 The insurance undertaking should define the rules for reporting cases of occurrence of the risk of non-compliance with the requirements of the Decision.

- 1.9 The insurance undertaking should ensure an appropriate distribution of tasks and responsibilities within its organisational structure to ensure the adaptation of its offer of products to the requirements of the Decision. In particular, appropriate tasks in this regard should be assigned to the actuarial office and individuals responsible for investments.
- 1.10 The insurance undertaking should ensure that appropriate organisational units will be required to provide the risk management function, the actuarial function, and the internal audit function and the compliance function with information about any facts which are relevant to ensuring compliance of the undertaking's business with the requirements laid down in the Decision.

POLICIES, STRATEGIES AND PROCEDURES

- 1.11 An insurance undertaking should consider the requirements of the Decision in its business strategy, in particular product strategy, actuarial strategy and distribution strategy.
- 1.12 An insurance undertaking should consider the requirements of the Decision in the relevant reporting processes and procedures, in particular in product development processes and the investment policy.
- 1.13 An insurance undertaking should define in its written procedures the rules, scope and frequency of the tests of compliance with the Decision, as well as situations which require *ad hoc* compliance tests. The procedures should be designed so as to take into account the individual features of the product and allow for the proper management of the risk associated with the existence of unit-linked insurance contracts prohibited under the Decision in the undertaking's offer. The tests of compliance with the Decision should be properly recorded.
- 1.14 The insurance undertaking's internal procedures should define the rules applicable in case of non-compliance of unit-linked insurance contracts being offered with the requirements of the Decision.

RISK MANAGEMENT

- 1.15 By means of regular reviews, an insurance undertaking should consider the risks, including insurance and investment risks, resulting from the Decision.
- 1.16 The risk management function should regularly monitor the level of the undertaking's risk to the extent resulting from the Decision and ensure effective management reporting in this area. Information about any risk associated with the implementation of the Decision that has been found to be potentially material should be communicated to the management board at least quarterly, until the risk associated with the implementation of the Decision is considered to be immaterial.
- 1.17 The insurance undertaking should take into account the impact of the Decision in its regular Own Risk and Solvency Assessment (ORSA), including by:

- providing information about the threats related to the Decision,
- considering the impact of the capital requirements projection,
- considering the impact of the Decision in the assessment of the overall Own Solvency Needs (OSN),
- including conclusions on the completed compliance tests that have been communicated to the management board,
- outlining the management activities which have been undertaken and those which are to be undertaken in connection with the Decision.

1.18 The risk management function should regularly verify the set level of risk appetite and the overall limits on risk tolerance, considering the impact of the Decision on the undertaking's risk profile.

INTERNAL AUDIT

1.19 The insurance undertaking should take into account, in its internal audit plan for 2022, a review comprising the assessment of adaptation of the undertaking's business to the requirements of the Decision. The internal audit function should assess, in subsequent years, the appropriateness of performing an audit for the purpose of verification of the adaptation of the undertaking to the Decision.

1.20 The reporting of the internal audit function should include information about the findings of the performed audits covering the adaptation of the insurance undertaking to the requirements laid down in the Decision.

COMPLIANCE

1.21 As part of the process of managing the risk of non-compliance, the compliance function should identify the risk of non-compliance with the Decision, in particular in the process of developing/modifying products.

1.22 The insurance undertaking should consider, in its compliance assurance plan for 2022, the activities of the compliance function in the area of assessment of the adaptation of the insurance undertaking to the Decision.

ACTUARIAL FUNCTION

1.23 In accordance with Article 272(8) of Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 2015 No 12, p. 1), the actuarial function should document, in a written report to be prepared at least annually, all tasks that have been undertaken and their results, and clearly identify any deficiencies and give recommendations as to how such deficiencies should be remedied.

1.24 In assessing the risk to be covered, the actuarial function should assess, in the above-mentioned written report, the implementation of mechanisms for verifying compliance with the prohibition specified in point I.1 of the operative part of the Decision.

COOPERATION WITH INTERMEDIARIES

1.25 An insurance undertaking should implement mechanisms to ensure immediate suspension of the sale/distribution of the product if it identifies non-compliance with the requirements of the Decision.

1.26 In the case where the product is designed and developed jointly by the insurance undertaking and an insurance intermediary and both entities take part in decision-making in designing and developing the product, the insurance undertaking should include, in the written agreement with the insurance intermediary setting out the terms of their cooperation and their respective roles, provisions ensuring compliance of the product with the Decision.

2. COMPLIANCE TESTS

In order for an insurance undertaking to ensure that the unit-linked insurance contracts being marketed, distributed and sold by it comply with the Decision, the insurance undertaking should perform a product compliance test prior to its marketing.

2.1 The conduct and assumptions used for the purpose of compliance tests

All unit-linked insurance contracts marketed, distributed and sold as of 1 January 2022 should comply with the requirements under the Decision. An insurance undertaking should therefore set such level of fees so as to ensure compliance with the prohibition specified in point I.1 of the operative part of the Decision for unit-linked insurance contracts to be concluded as of the effective date of the Decision.

The assumptions used to calculate the average return on assets referred to in point I.1 of the operative part of the Decision should take into account all fees and commissions collected as part of the unit-linked fund.

Compliance with the prohibition specified in point I.2 of the operative part of the Decision should include the review of the investment policy of each unit-linked fund and the review of composition of assets of each unit-linked fund.

2.2 Frequency of compliance tests

The review of compliance with the prohibitions should be done in the form of regular compliance tests to be performed by the insurance undertaking at least every 12 months.

The tests may be conducted more frequently, if the insurance undertaking deems it appropriate, as part of the estimation of the occurrence of risk of non-compliance with the prohibitions specified in the Decision.

A greater frequency of compliance tests may depend on, for example, factors such as:

- a difference between the maximum level and the current level of fees,
- possible changes of interest rates and external fees collected from the fund,
- the amount of work needed to make changes to the product, and
- operational issues related with withdrawal from sale or suspension of sale of a given product.

The process of performing compliance tests should be formalised and its results should be recorded and stored.

2.3 Requirements for tests

The test should be performed for each unit-linked fund available as part of the product, for each acceptable age of the client, and for each amount of the premium that a client may pay, as well as for other possible parameters/features of the contract which affect the test result, depending on the product, e.g. the level of insurance cover. The verification may be done for only several sets of parameters if that ensures the fulfilment of the requirement laid down in point I.1 of the operative part of the Decision for all possible choices made by the client, for example tests may be performed only on the unit-linked fund within which the highest fees are collected.

As regards the requirement laid down in point I.2 of the operative part of the Decision, an insurance undertaking must ensure that the assets of an unit-linked fund to be offered as of 1 January 2022 will not be invested in CoCos throughout the period of validity of the Decision, even if the insurance undertaking withdraws a certain unit-linked fund from its offer during that period (which is to protect the interest of clients who have acquired the product between 1 January 2022 and the date of its withdrawal from the offer).

2.4 Stages of tests

2.4.1 By the effective date of the Decision

The test should cover the products being offered, to establish whether they may continue to be offered as of the effective date of the Decision (a one-off compliance test prior to the entry into force of the Decision).

As part of management reporting the insurance undertaking's organisational unit responsible for product valuation prepares documentation confirming the completion of the compliance test, based on the technical specification of products, considering any indexation of fees

applied from the date of marketing of such products, and then submits the documentation to the management board.

As part of management reporting the insurance undertaking's organisational unit responsible for investing the assets of unit-linked funds, or any other unit indicated by the management board, assesses the manner of investing the assets which are to continue to be offered after 1 January 2022, in order to identify the unit-linked funds which may still be part of that offer. The unit prepares a list of such funds and submits it to the management board. The management board should adopt solutions to ensure that for the unit-linked funds on the list which are incorporated, by decision of the management board, in the offer of products available as of 1 January 2022, no change will be made in terms of asset management – it will still be impossible to acquire CoCos from the assets of those funds, throughout the period of validity of the prohibition specified in point I.2 of the operative part of the Decision.

2.4.2 Prior to the marketing of products

The test should cover each new product which is to be marketed and each unit-linked fund being offered as part of that product (the stage following the entry into force of the Decision).

Where a new product is marketed, or where changes are made to a product, the prohibitions following from the Decision should be observed at the time of implementing or modifying the product. In particular, for the prohibition specified in point I.1 of the operative part of the Decision, compliance should be ensured by adopting the fees and the projected amount of RFRs which are most up-to-date at the time of marketing the product.

In the case of marketing a new product on or after 1 January 2022, or where changes are made to an existing product, by adding such unit-linked fund to the list of the funds offered as part of such product, the insurance undertaking ensures that the rules for investing the assets of such fund exclude the acquisition of CoCos from those assets. The relevant provisions of those rules may be formulated explicitly, by stating that the assets of the unit-linked fund must not be invested in CoCos, or implicitly, for example by indicating the asset classes in which the unit-linked fund may invest, and such asset classes must exclude all CoCos.

In the case of marketing a new product, with a unit-linked fund established before 1 January 2022, and in the case of making changes to an existing product by adding the unit-linked fund to the list of funds offered as part of the product, the insurance undertaking should adopt solutions to ensure that the manner of investing the assets of that fund exclude the acquisition of CoCos and that it remains unchanged over the entire period of validity of the prohibition specified in point I.2 of the operative part of the Decision.

2.4.3 At least every twelve months, in relation to all products being offered at a given moment

The test should include the review of compliance with the criterion specified in point I.1 of the operative part of the Decision, taking into account the product assumptions used in the technical specification, and:

- the most recent amount of projected RFRs, in accordance with the Decision,
- the updated amounts of the fees collected which took place after the product was marketed.

2.4.4 During the period of validity of the prohibition specified in point I.2 of the operative part of the Decision, an insurance undertaking ensures on an ongoing basis that the assets of the unit-linked funds under the products offered, distributed or sold on or after 1 January 2022 are not invested in CoCos.

2.5 Calculation of the average return on assets

Point I.25 of the Decision contains a definition of ‘average return’, according to which the calculation of the contract value at the end of year *N* should take into account all the fees and commissions collected from the fund, both the fixed and the variable ones, according to the expected value. The management fee is mentioned only as an example of one of such fees. For fees/commissions determined by the rate of return (e.g. the success fee for ‘breaking’ a certain benchmark), an insurance undertaking may make the calculation using the methods used to determine the technical provisions for solvency purposes.

If, as part of a product, additional contracts are financed from the fees collected from a unit-linked fund, such fees should also be considered in calculating the average return. The expected value of benefits under an additional contract should also be considered in calculating the average return as defined in point I.25 of the Decision. The value should be calculated according to the assumptions used to calculate the technical provisions for solvency purposes. This rule applies to all the benefits under the contract, not only death benefits.

It is possible to exclude from the test the premiums for coverage and the related benefits under additional contracts if such contracts are financed from separate premiums which do not increase the value of the unit-linked fund under the main contract. To establish whether it is possible, it is necessary to apply the rules in accordance with the requirements of regulations on solvency.

2.6 Investments in CoCos

The definition of CoCos provided in point I.7 of the Decision does not include any type of shares disposed of or issued by investment funds or collective investment institutions. This means that the issue of any indirect exposure of assets of unit-linked funds to the risk associated with CoCos arising from the investments of unit-linked funds in shares disposed of or issued by investment funds or collective investment institutions is excluded from the scope of the Decision.

A unit-linked fund established before 1 January 2022 whose assets have not been invested in CoCos may be offered following the entry into force of the Decision if such manner of investing

the assets of the unit-linked fund (i.e. the lack of exposure to CoCos) is maintained by the insurance undertaking in the future, throughout the period of validity of the Decision.

3. ADAPTATION MEASURES

The supervisory authority expects that following the implementation of the Decision, insurance undertakings will provide information about the condition of their portfolio and the implementation of assumptions made by them as to how the Decision is to be implemented. The supervisory authority will provide appropriate reporting forms, to be available in the SNU application in October/November and to be completed by 31 December 2021.

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