Insurance briefing

What is going on in the insurance industry?

April 2017

The newsletter

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Introduction

Dear readers,

2016 was a challenging year for insurers and reinsurers, with Solvency II coming into effect from the 1st of January, along with the turmoil of the PRIIPs Regulation and the publication of the Insurance Distribution Directive. Also noteworthy are taxation issues, new data protection rules and the impact of the EMIR Regulation.

However, difficulties also present opportunities for learning and 2017 is proving that the insurance industry in Europe responds quickly and effectively to challenging times.

With a dedicated team to assist our insurance and reinsurance clients, KPMG Luxembourg follows these developments closely and proposes tailored solutions for each line of business, service and country.

We have therefore prepared a brief update on the topical themes for insurers from a regulatory perspective. We hope it is useful for you and would welcome your comments, suggestions for discussion and points of view.

Best regards,
Stanislas Chambourdon

The figures

€1,200 billion

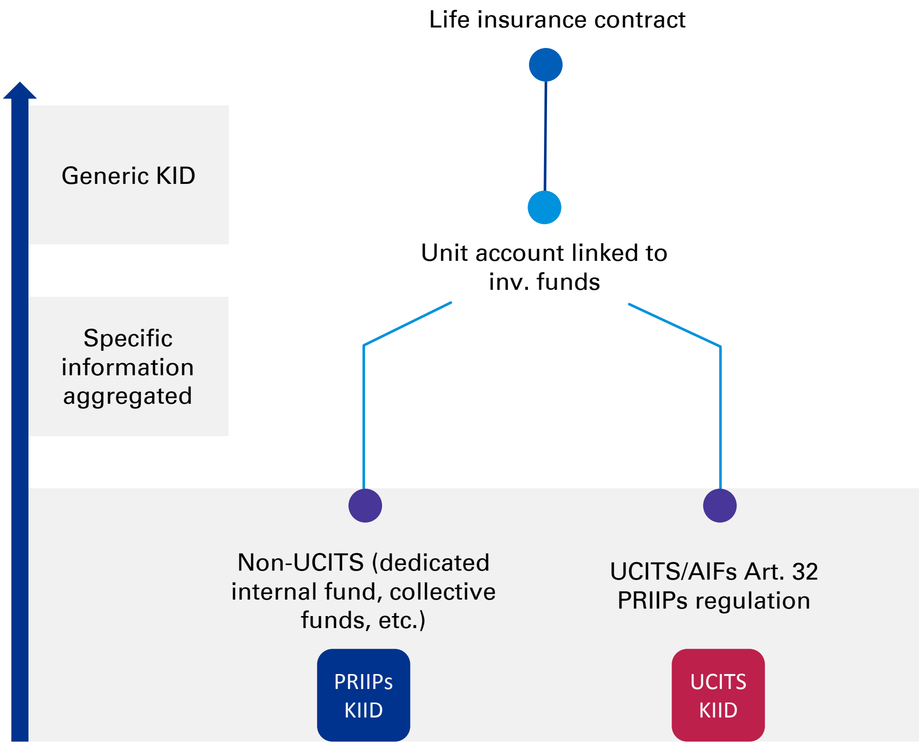
Total European gross written premiums in 2017

Source: Insurance Europe — Key Facts August 2016 http://www.insuranceeurope.eu/european-insurance-%E2%80%94-key-facts

PRIIPs Regulation: the end of uncertainty?

Are we nearing the end of PRIIPs KID and KIID uncertainty? Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation seems to always provoke animated discussion : the difficulties in implementation and the uncommon legislative process, following a debate among the European legislators on the Regulatory Technical Standards (RTS), mean there is ambiguity on how to comply with the PRIIPs Regulation provisions.

We hereby go step by step through the last RTS draft approved by the European Commission on 8 March this year, currently being discussed at the European Parliament and Council for final vote of the European legislators.



One of the ways to apply the RTS on a life insurance contract, in cases with MOPs: UCITS KIIDs can be used for the purposes of specific information on each investment option.

Multi-Option Products (MOPs):

The European Commission has developed a new approach to the Key Information Document (KID) for MOPs,

Where UCITS or AIFs benefiting from an exemption under Article 32(2) of the PRIIPs regulation are held in the portfolio underlying the life insurance contract (standalone or combined with other investments) and where a generic KID is given with specific information on each option pursuant to Article 14.1 of the RTS, the UCITS Key Investor Information Document (KIID) can be used to provide such specific information.

If the portfolio contains only UCITS or exempted AIFs, the information to be aggregated at the generic level can be collected and presented following the UCITS rules. If the portfolio contains investments other than the UCITS and AIFs, the UCITS KIID data shall be combined with the PRIIPs information relating to these investments to aggregate data at the generic level. In order to present the transaction cost figures that are absent from the UCITS KIID, such portfolios can apply the simplified methodology foreseen by the RTS for new funds.

Performance scenarios and summary cost indicator:

To calculate the summary cost indicator, a performance of 3% will be used for UCITS and AIFs, in line with the fixed percentage used for category 1 PRIIPs (Point 71 Annex VI new RTS).

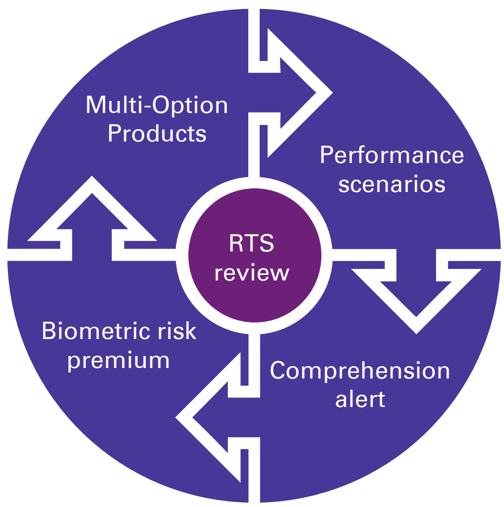
The fourth performance scenario is replaced by the "stress scenario" and Annex IV RTS June 2016 is updated accordingly (Article 3 and Annex IV new RTS).

Comprehension alert:

The EU clarifies that the comprehension alert is required where a PRIIP is an insurance-based investment product that is considered complex and does not benefit from the exemptions established in IDD or where a PRIIP is an investment product that does not meet the requirements of Article 25(4) of Markets in Financial Instruments Directive (MiFID).

Biometric risk premium:

Although the biometric risk premium will still be considered as cost, it will no longer be presented within the cost section but will be referred to in the section describing the characteristics of the product.



Insurance Distribution Directive

More than a year ago, the Insurance Distribution Directive (IDD) was published in the Official Journal of the European Union, to be transposed into the legal frameworks of the MS by 23 February 2018. In the Luxembourg insurance market, the IDD has been largely overshadowed by the legislative process concerning the PRIIPs regulation. However, the sector is beginning to react due to the time constraints and insurers, reinsurers and distributors are preparing themselves even though the law transposing the IDD is still to be enacted.

Why an IDD and why now?

During the financial crisis, which significantly affected many policyholders, the European Insurance and Occupational Pensions Authority (EIOPA) noticed that the distribution of insurance in the EU was not harmonised enough and that many distributors were not regulated. The Insurance Mediation Directive, currently in force, targets intermediaries only.

The EIOPA has therefore assisted the European Commission in preparing a directive that covers all types of distribution and insurance, and reaches all channels, applying as well to e-commerce and digitalisation developments also affecting the insurance industry.

To address these challenges, the European legislator has conceived a directive that tackles the current weaknesses but is, at the same time, a "de minimis" directive, allowing the Member States to adapt it to their framework and impose stricter rules, provided these are proportionate.

The IDD is sometimes called "the MiFID of insurance" since it mirrors the financial markets to an extent, aiming at establishing the rules on product manufacturing and distribution to ensure consumer protection (target market, remuneration, inducements and complex products), as well as enhancing cooperation among national supervisory authorities.

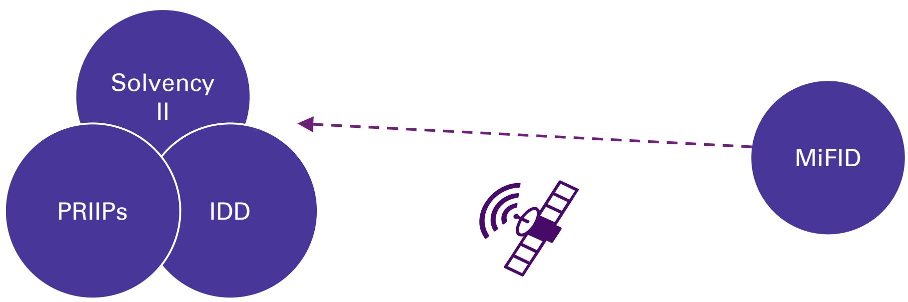
As mentioned, the IDD focuses on all insurance distributors, including: direct distribution by insurers and reinsurers, intermediaries and brokers, ancillary intermediaries, internet sellers, travel agents and car rentals. They now need to comply with the following rules:

- Be of good repute, act honestly, fairly and professionally, and possess adequate knowledge and ability;
- Avoid conflicts of interest and follow the inducements policy;
- Provide the proper pre-contractual information to customers (Insurance Product Information Document [IPID] for non-life insurance);
- Maintain, operate and review the relevant processes for the approval of each product (national supervisors to follow the Guidelines on Product Oversight and Governance, POG) before its distribution to the target market, previously identified;
- Additional requirements for insurance-based investment products.

In addition, the IDD outlines specific rules for intermediaries, who shall:

- Be registered with a competent authority in their home Member State (MS);
- If intending to conduct business within the territory of another Member State for the first time, notify and provide the relevant information to the competent authority of its home MS;
- Receive continuous training, at least 15 hours per year, and obtain the relevant certification;
- Hold professional indemnity insurance against any liability arising from professional negligence for at least EUR 150,000 per claim and, on aggregate, EUR 1,850,000 per year for all claims.

The second level of regulation is currently in preparation, focusing on the insurance-based investment products; the production of the IPID; and product oversight and governance, conflicts of interest and inducements for all types of insurance.



The IDD mirrors some aspects of the MiFID regime, but always from an insurance perspective.

In and out

EMIR for insurers: the collateral challenge

On 31 January 2017, KPMG Luxembourg organised a seminar for insurers focused on the European Markets Infrastructure Regulation (EMIR) and how to comply with the regulatory framework in Luxembourg while at the same time adapting to the European requirements.

The challenge is around collateralisation: insurers are required to provide collateral in case the assets underlying the insurance policies contain OTC derivatives not centrally cleared. But insurers cannot collateralise assets representing the technical provisions of the insurance contract. How to do it then? Will the *Commissariat aux Assurances* (CAA, the Luxembourg insurance regulator) accept an exception in the collateralisation rules?

The CAA published a Circular Letter on 23 March 2017, specifying the methods to exchange collateral in the context of life insurance contracts where the investment risk is borne by the policyholder. Through this text, the CAA underlines the prohibition to use the assets underlying an internal dedicated fund (or to create a sub-account inside the dedicated internal fund) as collateral for EMIR, based on article 56 of the CAA Regulation 15/3. The CAA presents two alternative options to the industry:

- Direct debiting of the necessary amounts from the technical provisions of the insurance contract, in the form of, for example, partial surrender or financial charge. This debiting shall be made transparently and upon a client's agreement. In addition, the restitution obligation linked to the amounts made available for EMIR but not used yet shall be reflected accordingly as a balance sheet item, and included in the statements sent regularly to the policyholders.
- Own funds can be used to provide the EMIR collateral, followed by a re-invoicing of the related

Impact of EMIR for insurance companies

The regulatory timeline

Regulatory developments are coming faster than ever — let's catch up!

PRIIPs: Upon the approval of the RTS by the European Commission on 8 March 2017, a scrutiny period has begun at the European Parliament and Council level. While it officially lasts three months, it should be shorter considering both institutions agree.

IDD: Luxembourg is working on the law transposing IDD, which is expected to be ready by 23 February 2018. Delegated acts are being prepared and should be published in the coming months.

Institutions for Occupational Retirement Provision (IORPs): The IORP II Directive, recasting the IORP 2003 Directive, was published in the Official Journal of the European Union on 23 December 2016, aimed at fostering the activities of IORPs across the EU and facilitating the cross-border transfers of these entities.

Data protection: The current Data Protection Directive will be repealed by the Regulation (EU) 2016/679 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, which will apply from 25 May 2018.

Anti-Money Laundering IV Directive: The transposition deadline imposed by the directive was 26 June 2017, although it was advanced to 1 January 2017.

* Source: Venture Pulse Q3 2016, issued by KPMG and CB Insights.

Artificial avoidance of permanent establishment status

In line with the trend of increasing tax transparency, led by the OECD, the BEPS project sets out 15 actions to reform the international tax framework. Its purpose is to ensure that profits are reported where economic activities are carried out and value is created.

To ease the implementation of the BEPS Action Plan, the OECD added a multilateral instrument (the "**MLI**") to BEPS Action 15, so countries could swiftly amend their treaty network. The MLI covers various anti-BEPS measures including BEPS Action 7, which prevents artificial avoidance of permanent establishment ("**PE**") status, and could have the biggest impact on the insurance sector.

The MLI tackles the perceived artificial avoidance of a PE through commissionaire and similar arrangements by increasing the scope of dependent agent PEs.

An enterprise shall be deemed as having a PE in a country (subject to additional conditions) where: a person is operating in a country on behalf of said enterprise and habitually concludes contracts or plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise. The important change introduced here is the reference to the "principal role leading to the conclusion of contracts" (as opposed to the conclusion of contracts).

This new rule shall, in principle, not apply where the activities are performed through an independent agent. However, where a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person will no longer be considered an independent agent.

The combination of these two elements significantly enhances the scope of activities that could lead to the recognition of a PE. The next questions, therefore, are how and when provisions of the MLI will be implemented? In a nutshell, the provisions of the MLI should apply with respect to double tax treaties where:

- both Contracting States have decided to apply the MLI and, more precisely, to apply it in the context of their bilateral relationship; and
- the Contracting States have chosen to apply the relevant provision and to do it in an identical way (e.g. no reservation).

Countries thus need to position themselves.

As the Luxembourg market is limited, insurance sector players leverage the local expertise and the multilingual capabilities of the workforce to sell their products and services across the EU. To do so, they often act on the basis of the freedom to provide services and use the services of agents or intermediaries. The MLI could have a material impact on this landscape. Whereas the recognition of a PE does not necessarily mean more taxes, it does create an increasing administrative burden (e.g. reporting obligations).

The Grand Duchy's position on this matter is not known at this stage. Considering the positions of other countries (such as the UK), as well as the interest for Luxembourg in maintaining a level playing field in Europe, its decision on whether to implement certain provisions of the MLI, notably Article 12, and to make reservations on some of those, is likely to be closely monitored by the market.

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