Insurance Newsletter

Quarter 3 2016

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KPMG Malta

Introduction

Welcome to the 2016 Q3 Insurance e-newsletter.

In this newsletter, we are providing updates on issues facing the insurance industry and inform on what KPMG is talking to regulators about, both locally and globally. We share developments on these issues and any new issues which arose over the last quarter. From now onwards, we will also start providing news on Pensions initiatives being discussed in the European Union ("EU").

Contents

1. Key Information Documents for Retail Investors in the EU

In the newsletter for Q2 2016, it was highlighted that the Joint Committee of European Supervisory Authorities ("ESAs") had finalised its proposal for Regulatory Technical Standards ("RTS") on the Key Information Document ("KID") for Packaged Retail and Insurance Based Investment Products ("PRIIPs").

On 30 June 2016, the European Commission ("Commission") adopted a delegated act supplementing the PRIIPs regulation, introducing the RTS which specifies the content and underlying methodology of the KID. The KID must be provided to retail consumers when they buy certain investment products, including unit-linked policies and with-profits policies. The PRIIP legislation is due to come into force on 31 December 2016.

On 1 September 2016, the Committee on Economic and Monetary Affairs of the European Parliament ("ECON") issued a statement stating its unanimous rejection to the RTS. ECON have issued proposals to revise the RTS. It has called on the Commission to submit a revised RTS that addresses their concerns and to delay the application date of the regulations until an acceptable RTS has been approved. The main objections were around the KID which could present information that was misleading and flawed.

The European Parliament has voted to reject the detailed rules needed to implement the KID by the beginning of next year.

2. Advice on Infrastructure Corporates

On 30 June 2016, the European Insurance and Occupational Pensions Authority ("EIOPA") published its Technical Advice to the Commission on the identification and calibration of infrastructure corporates.

This was based on the Commission's request for EIOPA to further elaborate on the previous advice, to introduce a new asset class under Solvency II, to cater for investments in infrastructure projects. In its latest advice, EIOPA recommended that this asset class should be introduced in two ways:

(1) To allow certain infrastructure corporates to qualify for the treatment of infrastructure projects provided that there is an equivalent risk level. EIOPA's proposals are to change the definition of 'infrastructure project' to provide some flexibility in the financing structure and the contractual framework requirements to allow relevant infrastructure corporates to qualify; and
(2) To create a separated differentiated treatment for equity investments in high-quality infrastructure corporates.

EIOPA also proposed to reduce risk charges for equity investments for infrastructure corporates that have a lower risk profile. As part of this advice, insurers are required to perform their own due diligence, establish written procedures to monitor the performance of their exposures and perform stress testing on the cash flows and collateral values supporting their investment.

> "Infrastructure corporates are entities or corporate groups which carry out infrastructure activities (energy generation, social housing, healthcare/ hospitals, etc.)."

3. Launch of EU-wide Thematic Review On Market Conduct

EIOPA launched an EU-wide thematic review on market conduct with respect to insurance companies operating in the unit-linked life insurance market. The review aimed to cover 60% of each national market in terms of both gross written premiums and assets of unit-linked funds. The objective of the review is to identify potential sources of consumer detriment stemming from the relationships between insurance companies and the providers of asset management services. This review focused on 3 key issues:

(1) The existence and characteristics of monetary incentives and remuneration;
(2) How conflict of interest is addressed by insurance companies; and
(3) The structure of unit-linked life insurance products.

The review was conducted in close cooperation with the National Competent Authorities, who identified the participating insurance companies. Relevant data and information was then obtained from the national market. The participating companies reported back in September 2016, with the results of this review to be disclosed in early 2017. This review is expected to serve as an important step in EIOPA's strategy to put in place a comprehensive risk-based and preventive framework for the supervision of the conduct of business by insurance companies. Any updates on this review and the results arising therefrom, particularly those from the Maltese perspective, will be communicated once available.

4. Consultations

EIOPA Consultations

Policy Proposals Regarding the Implementation of the Insurance Distribution Directive

On 4 July 2016, EIOPA published a Consultation Paper on its draft technical advice to the Commission on possible delegated acts concerning the Insurance Distribution Directive ("IDD"), following the request of the Commission.

This draft technical advice focusses on ensuring the following 3 objectives:

(1) The Insurance products meet the needs of consumers and prevent or mitigate mis-selling, throughout the product lifecycle;
(2) Different third party payments, for example commissions, do not have a detrimental impact on the quality of services provided to the customer; and
(3) The products sold to individual customers by insurers and intermediaries are suitable for advised sales or appropriate for non-advised sales.

Interested parties were requested to provide their feedback on the following areas:

(1) Product oversight and governance;
(2) The prevention and management of conflicts of interest;
(3) The specification of circumstances under which inducements are paid; and
(4) The assessment of suitability and appropriateness and reporting to customers.

The consultation period ended on 3 October 2016. EIOPA intends to submit its technical advice to the Commission in February 2017.

Pensions Consultation

On 27 July 2016, the Commission launched a consultation on how to improve personal pensions - described as "long-term savings products with a retirement objective which are subscribed to voluntarily, and are neither social security-based nor occupational." This therefore offers opportunities for both the insurance and investment sectors.

The consultation seeks views on how to best address obstacles preventing greater take-up across the EU, with a view to assessing the feasibility of a potential EU policy framework to establish a successful European market for simple, efficient and competitive personal pensions.

The Commission clearly believes that if the provision of the (so-called) third pillar personal pensions by a wider range of financial institutions is made possible, this would foster competition and offer more choice to consumers. The aim is for consumers to gain access to simpler, more innovative and more efficient personal pensions to complement their retirement income.

The deadline for this consultation is 31 October 2016.

4. Consultations (2)

MFSA Consultations and Feedback Statements

The MFSA issued the following consultations and feedback statements during the third quarter of 2016:

(A) Consultations

CONSULTATION END DATE	REF	CONSULATION TOPIC	COMMENTS
23 SEPTEMBER 2016	8/2016	External audit of specific templates of the Solvency and Financial Condition Report	The feedback statement from the MFSA has not yet been published
30 SEPTEMBER 2016	9/2016	Minimum parameters to gain approval for intra-group loans	The feedback statement from the MFSA has not yet been published

(B) Feedback Statements

CONSULTATION END DATE	REF	CONSULATION TOPIC	COMMENTS
2 MAY 2016	3/2016	Intra-company loans within a group	Revised consultation issued by the MFSA on 9 September 2016 (Ref: 9/2016)
31 MAY 2016	4/2016	Conduct of business rulebook, Phase 2	The feedback statement from the MFSA has not yet been published
14 JUNE 2016	5/2016	Insurance Rules implementing Audit Committee requirements	The feedback statement was published on 18 July 2016 See note 1
11 JULY 2016	7/2016	Amendments to Listing Rules implementing Audit Committee Requirements	The feedback statement was published on 11 August 2016 See note 2

4. Consultations (3)

Note 1: Summary of Feedback Statement issued by the MFSA on 18 July 2016 (Ref: 5/2016)

1. The industry sought clarification as to whether the Audit Committees which are already in place will be effected by the new requirements. The MFSA confirmed that these are required to ensure compliance with the requirements introduced by Article 39 of the Statutory Audit Directive. The feedback received also pointed out that, due to their relatively small size, it would be difficult for captives or niche underwriters to comply with all the requirements. In this respect, the MFSA believes that, in such cases, it is appropriate to permit that the functions assigned to the Audit Committee are performed by the Board of Directors as a whole.

2. The industry requested clarification as to the expected fitness requirements in relation to the competence in accounting and/or auditing required to be possessed by at least one member of the Audit Committee. The MFSA is of the view that he/she must be in possession of the necessary qualifications or if not, he/she has the knowledge and practical experience acquired during a significant number of years which renders that person competent in accounting and/or auditing.

3. The industry requested clarification to the meaning of "independence" in relation to the requirement that a majority of the members of the Audit Committee and the Chairman of the Audit Committee are to be independent of the authorised undertaking. To this effect, the MFSA has clarified that in determining whether a member of the Audit Committee or Chairman of the Audit Committee may be regarded as independent of the authorised undertaking, the Board of Directors of the undertaking, in its assessment of independence, shall refer to Section 13 and Annex II of the 'Commission Recommendation of 15 February 2005 or the role of non-executive or supervisory directors of listed companies and on the committees of the supervisory board'. Annex II makes reference to the fact that the Chairman and Audit Committee members are deemed to be independent of the authorised undertaking if they are not serving as an executive or managing director of the company or an associated company, and have not been in such a position for the previous five years, and if they have not served as a partner or employee of the present or former external auditor of the company or an associated company within the last three years, among other criteria.

4. The feedback received suggested that the Chairman of the Audit Committee should be appointed by the Board of Directors and not by the Audit Committee. The MFSA noted these comments and has made the corresponding amendments to highlight the fact that the Chairman of the Audit Committee is to be appointed by the Board of Directors.

Note 2: Summary of Feedback Statement issued by the MFSA on 11 August 2016 (Ref: 7/2016)

1. The industry sought clarification with respect to the election of the Chairman and suggested that he/she should be appointed by the Board of Directors. The MFSA agreed with the industry's position and will be amending the Listing Rules to this effect.

2. The feedback received suggested that a distinction should be made between issuers which have debt securities listed and those which have their equity listed. The MFSA disagrees that such a distinction should be made on account of the fact that the Audit Directive does not make such a distinction and that the Audit Committee has played a vital role in respect of issuers of debt securities.

3. The feedback received suggested that a public-interest entity may not have an Audit Committee provided that it has a body performing equivalent functions. The MFSA did not agree to introduce this option as it is not aware of other committees that can perform the functions of the Audit Committee.

4. The feedback received suggested that the requirement to disclose the independent members and the member/s competent in accounting and/or auditing, together with the reasons for this, in the Statement of Corporate Governance should be removed or retained on a voluntary basis. The MFSA believes that this requirement should be retained as it ensures that the right persons are appointed to the Audit Committee.

5. Other News

Representative Portfolios for the Calculation of the Volatility Adjustment

EIOPA published updated representative portfolios that will be used for the calculation of the Volatility Adjustment ("VA") to the relevant term structure of risk-free interest rate for Solvency II. This data will be used for the VA calculation with reference date 30 September 2016.

These portfolios are based on more up-to-date and granular data, enabling more accurate reflection of the impact of market volatility under the Solvency II regime. EIOPA intends to revise the representative portfolios on a yearly basis. The next update is planned for the second half of 2017.

Development of an EU Single Market for Personal Pension Products

On 6 July 2016, EIOPA published its final advice on the further development of a single EU market for personal pension products. In its advice, EIOPA reiterates its view that a standardized Pan-European Personal Pension Product regulated by a 2nd regime for personal pension has the best potential to promote the Single Market and to strengthen the regulatory framework for the benefit of consumer protection.

Insurance Distribution Directive Public Hearing

EIOPA held a public hearing on the draft technical advice on possible Delegated acts concerning the IDD on 23 September 2016.

Insurance Distribution Directive Online Survey

EIOPA launched an online survey on the empowerment to develop guidelines in line with Article 30(7) of the IDD. The deadline for this survey was 25 September 2016.

We hope that you have found this e-newsletter interesting. If you would like further information on any of the topics above or have any other questions relating to Solvency II or other insurance topics, please feel free to contact any member of the KPMG Insurance Advisory Team.

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