

CONSULTATION PAPER NO. 8/2023

DRAFT LETTER TO THE MARKET ON INSURANCE PRODUCT OVERSIGHT AND GOVERNANCE (POG) – IVASS’S EXPECTATIONS

The document contains the supervisory expectations on Product Oversight and Governance (POG) addressed to insurance undertakings, in order to foster the consistent and adequate application of the relevant European and national regulatory framework in accordance with the standards of sound and prudent management, transparency and fairness towards customers and, in compliance with the proportionality criterion, to be implemented according to the operational, dimensional and organisational complexity, as well as the nature of the activity carried out.

Without prejudice to the fact that the expectations are intended to ensure maximum protection of customers, in accordance with the **proportionality** criterion, the relevant operational implementation is left to the individual undertaking, which must take into account the dimensional-organisational complexity, the nature and scale of the risks associated with the business actually carried out, the level of complexity of each insurance product and the related target market.

Expectations take the form of general, non-binding guidance on how IVASS expects undertakings to comply with the current POG framework. IVASS’s expectations are contained in specific numbered boxes, broken down into detailed indications on the various profiles referred to therein, also numbered and, where appropriate, accompanied by the relevant regulatory references or evidence from supervisory analyses that justify the choices made by IVASS.

With a view to ensuring transparency, the letter also discloses to the market the methodologies adopted by IVASS in its supervisory analyses and checks on certain profiles of particular importance.

Any observations, comments and proposals on the numbered expectations and indications may be sent to IVASS by 6 November 2023 (30 days) to the following e-mail address: letteraalmercatoPOG@ivass.it using the attached table, to be completed in Word format.

Personal data provided when participating in the public consultation will be processed by IVASS (Data Controller) for the purposes provided for in Regulation (EU) 2016/679 (GDPR), exclusively for the performance of its tasks of public interest or anyhow for purposes related to the exercise of its public powers.

At the end of the public consultation phase, the following will be made public on IVASS website:

- comments received, indicating the sender, except for data and information for which the sender requests confidentiality, stating the reasons. The generic warning at the bottom of the e-mail concerning the confidentiality of the content of the e-mail will not be considered a request not to disclose the comments sent. Comments received after

the deadline indicated above will not be taken into consideration;

- the resulting IVASS resolutions, which may also be drafted in summary form, without the need for specific feedback for each comment received (Article 8(1) of IVASS Regulation No. 54 of 29 November 2022).

The structure of the document submitted for public consultation is not intended to preclude the possibility of subsequent integration over time to take into account the development of best practices, the evolution of the reference regulatory framework and the results of the supervisory analyses conducted by IVASS in the exercise of its functions.

Similarly, the placement of specific indications or expectations in new or existing IVASS Regulations, Orders or provisions is not precluded.

Rome, 6 October 2023

Draft LETTER TO THE MARKET ON INSURANCE PRODUCT OVERSIGHT AND GOVERNANCE (POG) – IVASS’S EXPECTATIONS

Presentation report

1. The regulatory framework and underlying principles

The rules on product oversight and governance requirements applicable to insurance undertakings derive from directly applicable European sources and from the revised national legislation following the transposition of the Insurance Distribution Directive (hereinafter, IDD)¹ which, in Article 25, had introduced product governance obligations² on manufacturers and distributors manufacturing insurance products.

Over the years, the POG provisions in the IDD have been supplemented by European and national provisions. Specifically:

at European level:

- by the Commission Delegated Regulation (EU) 2017/2358 of 21 September 2017 (hereinafter “POG Delegated Regulation”), which specifically regulated: i) the product approval process of insurance product manufacturers, with particular regard to the identification of the target market, product testing, product monitoring and review, and the ensuing relationship with distribution channels; ii) the product

¹ Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution, transposed into the Italian law by legislative decree no. 68 of 21 May 2018, which has amended the CAP.

² Borrowing from EU Directive No. 65/2014 (so-called MiFID II Directive). In particular, Article 25 of the IDD introduced consumer protection safeguards from the time of product design and launch to ensure that the interests of the target market are adequately taken into account. The safeguards extend throughout the whole life of the product, providing for its monitoring over time to ensure that it continues to meet the interests of the type of customers for whom it was realised.

distribution arrangements and the information that the distributor is required to provide to the insurance product manufacturer;

- by some EIOPA documents, better described in Section 2, aimed at supporting undertakings and distributors in the implementation of their POG policies, so that they can better interact with the Supervisor³;

at national level:

- by the provisions of article 30-*decies* of the Code of Private Insurance (hereafter, CAP) introduced by Legislative Decree No. 68 of 2018 implementing the IDD, which, in particular, requires insurance undertakings and intermediaries which manufacture insurance products to: (i) define and implement a process for the approval of each insurance product and for each significant change to an existing insurance product, before it is marketed or distributed to customers; (ii) identify a target market for each product, where the definition of target market includes the categories of customers for whom the product is intended (the so-called positive target market); (iii) identify, for each product, the categories of customers to whom the product may not be distributed (the so-called negative target market); (iv) take any reasonable step to ensure that the insurance product is distributed to the identified target market; (v) make available to insurance distributors all appropriate information on the insurance product and the product approval process, including the identified target market;
- by the letter to the market of 4 September 2017 on the POG requirements for insurance undertakings and insurance distributors;
- by the adoption of IVASS Regulation No. 45 of 4 August 2020, which implemented Articles 30-*decies*(7)⁴, and 121-bis(2) of the CAP. In particular, in line with the primary regulatory framework and consistently with the provisions of the aforementioned Delegated Regulation (EU) on POG, it regulates: i) the approval process and distribution activities for insurance products and (ii) the product approval and distribution processes for insurance-based investment products (hereinafter IBIP). With regard to the duties and responsibilities of the corporate bodies involved in the POG process, said Regulation is also in line with the IVASS provisions on the corporate governance system (IVASS Regulation No. 38 of 3 July 2018)

This is the background against which the draft letter to the market subject to the public consultation has been defined. Said letter is meant to communicate to insurance

³ EIOPA's approach to the supervision of product oversight and governance of 8 October 2020 (https://www.eiopa.europa.eu/content/eiopa-approach-supervision-product-oversight-and-governance_en?source=search); EIOPA Supervisory Statement on assessment of value for money of unit-linked insurance products under product oversight and governance of 30 November 2021 (https://www.eiopa.europa.eu/document-library/supervisory-statement/supervisory-statement-assessment-of-value-money-of-unit_en?source=search); EIOPA Methodology to assess value for money in the unit-linked market of 31 October 2022 (https://www.eiopa.europa.eu/document-library/methodology/methodology-assess-value-money-unit-linked-market_en?source=search).

⁴ Article 30-*decies* (7): "IVASS shall, after hearing Consob, adopt the provisions implementing this article so as to ensure uniformity in the regulations applicable to the sale of insurance-based investment products regardless of the distribution channel and overall consistency and effectiveness of the system of supervision over insurance-based investment products, pursuant to and in accordance with the provisions of article 5 (1) b), no. 1, of law no. 163 of 25 October 2017."

undertakings IVASS expectations in relation to POG by means of general indications aimed at giving appropriate implementation to the current provisions on the subject.

2. Purpose of the letter to the market

As part of its supervisory activity on the market conduct of insurance undertakings, IVASS carried out a series of checks on the implementation of POG regulations through requests for documentation, meetings and on-site inspections.

The activities conducted showed progress in product approval processes and related systems and control implemented by undertakings since the entry into force of the IDD, the IDD Delegated Acts on POG and national legislation.

However, serious shortcomings have been identified, for which we believe it necessary to urge undertakings to promptly adopt proper implementation strategies of the relevant regulations, particularly with relation to:

- the **governance systems of the POG process**, both with regard to the bodies and functions involved, and to the formalisation of appropriate policies and guidelines. The following were in fact found: (i) situations where there is a lack of effective involvement of the administrative body and of an autonomous and effective contribution of the so-called key functions⁵; (ii) gaps or ambiguities in the formalisation of roles and responsibilities; (iii) guidelines that are not adequately detailed and do not cover all stages of the POG process; (iv) insufficiently customer-oriented processes; (v) lack of appropriate analysis methodologies and thresholds for determining and evaluating product testing results;
- the **identification of the target market** and its granularity, which turned out, especially for insurance-based investment products (IBIPs) with multiple investment options, to be too broad and generic and unable to counter the risk of misselling;
- analyses to determine and measure the **value of the product for the customer** (value for money), which were often deficient from the customer's point of view, either because they were based on a comparison of the product with similar products of competing undertakings without any determination of the value of the product per se, or because they included assessments aimed at verifying the sustainability of the product and its profitability only from the undertaking's side.

In accordance with the initiatives already taken by other insurance supervisory authorities in the European Union, it is considered useful to make insurance undertakings aware of IVASS's expectations regarding POG, not only to help overcome the shortcomings encountered, but also for the benefit of the undertakings themselves, by offering guidance to facilitate the application of the regulations.

In fact, the expectations below identify the application practices that IVASS believes give adequate implementation to: (i) POG (Article 25), remuneration of the distribution activity and conflicts of interest (Articles 17(3), 27, 28 and 29(2) of the IDD); (ii) the directly applicable Delegated Acts on POG and IBIP distribution (Delegated

⁵ Risk management function, Compliance function, Actuarial function, Internal audit function.

Regulations (EU) 2017/2358 and 2017/2359); (iii) national implementing legislation, including regulations issued by IVASS (Regulations Nos. 40/2018 and 45/2020); (iv) the guidance provided by EIOPA on POG and the determination of the product value for money⁶.

In line with the *Supervisory Statement on assessment of value for money of unit-linked insurance products under product oversight and governance*, published by EIOPA on 30 November 2021, and given the peculiarities of the Italian market, IVASS's expectations are at this stage focused on the POG process and, in particular, on the assessment of the value for money arising from the product testing phase for IBIPs, thus including also class I with profit policies⁷.

Criteria inspired by the same principles and purposes of customer protection should guide the correct application of POG rules applicable to non-IBIP life products and non-life business.

In assessing the value for money of IBIPs, IVASS's expectations were defined on the basis of the harmonised methodology developed by the European supervisory community and published by EIOPA on 31 October 2022.

The following expectations are intended to provide general indications as to how to comply with the POG discipline. They are not binding, but undertakings that use methods other than those indicated will have to carefully evaluate the consistency of the solutions adopted, including with respect to the present expectations.

Lastly, in continuity with its supervisory action and as part of its supervisory analyses, IVASS will assess the level of compliance with its expectations in order to ensure the progressive and gradual alignment of business practices.

3. Scope

Expectations are addressed to insurance undertakings with head office in Italy and to the Italian branches of undertakings whose head office is located in non-EU states.

Moreover, in order to promote equal protection for Italian customers, in the framework of the cooperation relationships with the Home Supervisor on POG, IVASS will take the expectations into account and represent them to the Home Supervisor also in relation to products marketed in Italy by undertakings having their head office in the

⁶ Article 25 of Directive (EU) 2016/97 – IDD; Delegated Regulation (EU) No. 2017/2358; Article 30-*decies* of legislative decree No. 209 of 7 September 2005 – CAP; IVASS Regulations Nos. 38/2018 and 45/2020; EIOPA's approach to the supervision of product oversight and governance of 8 October 2020 (https://www.eiopa.europa.eu/content/eiopa-approach-supervision-product-oversight-and-governance_en?source=search); EIOPA Supervisory Statement on assessment of value for money of unit-linked insurance products under product oversight and governance of 30 November 2021 (https://www.eiopa.europa.eu/document-library/supervisory-statement/supervisory-statement-assessment-of-value-money-of-unit_en?source=search); EIOPA Methodology to assess value for money in the unit-linked market of 31 October 2022 (https://www.eiopa.europa.eu/document-library/methodology/methodology-assess-value-money-unit-linked-market_en?source=search).

⁷ In addition to the consideration of the specific characteristics of the Italian market, the extension to with profit policies also meets the criteria of homogeneity with the treatment applied to the with profit component of hybrid policies.

European Economic Area and pursuing business in Italy under the right of establishment or the freedom to provide services.

In line with the primary European and national regulatory framework and with the implementing regulations issued by IVASS, the expectations contain specific and detailed indications for IBIPs, with particular regard to those concerning the criteria governing the identification of the target market and the analyses for determining and measuring the value of the product for the customer (*value for money*). These expectations take adequate account of the guidance contained in the documents published by EIOPA and represent immediate guidelines for life undertakings manufacturing and distributing IBIPs.

It is understood that the same customer protection principles and objectives that govern guidance on IBIPs should guide undertakings in the correct application of POG rules, to the extent applicable, also with respect to non-IBIP life and non-life products.

Without prejudice to the fact that the expectations are intended to ensure maximum protection of customers, in accordance with the proportionality criterion, the relevant operational implementation is left to the individual undertaking, which must take into account the dimensional-organisational complexity, the nature and scale of the risks associated with the business actually carried out, the level of complexity of each insurance product and the related target market.

IVASS's supervisory activity will also be calibrated according to the same principle.

4. IVASS's supervisory activity

Pursuant to Article 9-bis(1)(b) of the CAP on the transparency of the Supervisory Authority, it should be noted that IVASS, in its supervisory processes on POG, will adopt the indications set out in the letter.

Please note that, within the framework of the various tools provided for in the harmonised EIOPA methodology, and taking into account the flexibility provided for therein, for the time being, IVASS favours the use:

- of tool 1 (*Approach based on PRIIPs KID data*) for *Layer I – market wide assessment*, with particular emphasis on KID⁸ data on RIY⁹ and expected performance;
- of tool 1 (*Product Profitability testing*) for *Layer II – enhanced supervision*, making use of the indicators set out in Section 11.1 and based on an examination of the policy conditions and the adoption of yield assumptions.

IVASS reserves the right to make the adjustments that are found to be necessary in the course of the application of these tools and which will be disclosed.

5. Regulatory impact assessment analysis

⁸ Key information document.

⁹ Reduction in Yield.

The draft letter to the market on insurance product oversight and governance of insurance undertakings stems from the need to ensure convergence in the application practices of the provisions arising from the relevant national and European regulatory framework.

Since this is an act having exclusively an interpretative or applicative purpose that may have a significant impact on the activity and organisation of the addressees, pursuant to Article 2(1)(a)(6) of IVASS Regulation No. 54/2023, only Articles 5, 6 and 8 of the same Regulation concerning public consultation shall apply.

The deadline for public consultation is set at 30 days.

Below is a list of 15 supervisory expectations, which include specific indications on the various profiles mentioned, some concrete examples, as well as explanatory paragraphs with regulatory references or evidence that came to light during the course of the supervisory activity. They concern: (i) the systems of governance of the POG process (with regard to the bodies and key functions involved and the formalisation of appropriate policies and guidelines); (ii) the criteria governing the identification of the target market; (iii) the analyses for determining and measuring the value of the product for the customer (*value for money*).

The definitions used essentially refer to those contained in primary and secondary European and national regulatory framework and the EIOPA documents referred to.

Expectations

POG governance systems

Article 4 of Delegated Regulation (EU) 2017/2358 requires manufacturers to maintain, operate and review the product approval process through measures and procedures for designing, monitoring, reviewing and distributing insurance products, as well as for remedial action for insurance products that are detrimental to customers.

Among the duties of the administrative body, Article 5(2)(e) of IVASS Regulation No. 38/2018 identifies that of determining the system of risk objectives, defining the undertaking's risk appetite, identifying the types of risk it considers taking on (and, if necessary, those that cannot be taken on), consistently setting the relevant risk tolerance limits, which it reviews at least once a year in order to ensure their effectiveness over time.

Pursuant to Article 5 of IVASS Regulation No. 45/2020, the administrative body of insurance undertakings is ultimately responsible for compliance with the rules on the approval process for insurance products. To this end, at least once a year it approves and updates the product oversight and governance policy for the insurance products referred to in Article 4 of Delegated Regulation (EU) 2017/2358; when updating the policy, it also makes use of a report from the competent corporate functions that gives an account of the state of implementation of the policy and of the problems that have arisen during its application.

1. IVASS expects:

- a. **the POG process, in its capacity as business process that applies straight from the product design phase, to be an integral part of the corporate system of governance and risk management and control system, and to be adequately considered in the organisational structure of the undertaking and in the allocation of tasks and responsibilities to operational structures and key functions;**
- b. **the administrative body to have adequate knowledge of the POG regulations in order to define strategic guidelines of the corporate system of governance and to verify how these strategic guidelines have been implemented in the undertaking.**

2 IVASS expects the insurance product oversight and governance policy (provided for under Article 4 of Delegated Regulation (EU) 2017/2358, approved by the administrative body and the content of which is set out in Annex 1 of IVASS Regulation No. 45/2020) to include clear guidelines on the granular identification of the target market, as well as on the performance of product testing. IVASS further expects this policy to define operational limits and quantitative thresholds, verifiable ex post, for the objectives set out in Article 8 of IVASS Regulation No. 45/2020 on the product value for money and, in particular, the provision of paragraph 2 letter a) concerning the checks to ensure that the costs and charges do not compromise the return expectations of the insurance-based investment product.

- 2.1. In relation to the definition of the target market and product testing referred to in Articles 6 and 8 of IVASS Regulation No. 45/2020, IVASS expects the product oversight and governance policy to provide clear and precise guidelines, which identify the variables to be taken into account, the main indicators to be assessed, and - in relation to the former - also to provide for quantitative thresholds, verifiable a posteriori. These guidelines should be stated either in the policy itself or in a document annexed thereto; this is with particular regard to the requirements of compatibility of costs and charges with the needs, objectives and characteristics of the target market and the appropriate value for money of the product for the customer.
- 2.2. As already explained in Annex 1 to Regulation No. 45/2020 on the content of the POG policy, IVASS expects the level of detail of these guidelines to be appropriate to the nature, scale and complexity of the business activity and to be proportionate to the complexity of the products manufactured by the undertaking.

Among the principles underpinning current legislation on corporate governance, organisational structures and risk management process, the clear distinction of roles and responsibilities and the appropriate balance of powers play a central role.

Pursuant to Article 7(2) of IVASS Regulation No. 38/2018, the senior management defines, in detail, the organisational structure of the undertaking, the tasks and responsibilities of the basic operational units, and the decision-making processes in line with the directives issued by the administrative body; within this sphere it implements the appropriate separation of tasks between individuals and between functions, so as to ensure adequate dialogue and avoid, as far as is possible, the occurrence of conflicts of interest.

3 As part of the product approval process, IVASS expects the key functions to validate the activities carried out by the operational units within the POG process by means of a complete and autonomous verification. For the approval of new products, a special committee must be set up in which the above-mentioned functions participate.

- 3.1. IVASS expects the key functions identified by the administrative body in the design of the POG process to be assigned the role of validating the product testing activities carried out by the operational units. This should be done by means of a complete and autonomous verification, which should also include the assessment of the quality and consistency of the data used in the product testing phase and the determination of the value for money for the identified target market, as well as for the assessment of the sustainability and profitability of the product from the undertaking's side.

4. In the definition of the corporate Risk Assessment Framework, and within the framework of the risk management system, IVASS expects the administrative body to give adequate consideration to the market conduct risk profiles associated with POG, including through the identification of the undertaking's risk objectives and any tolerance thresholds, without prejudice to the need to minimise the compliance risk.

- 4.1. In its connotations of operational (quantifiable), compliance and reputational (non-quantifiable) risk, conduct risk constitutes a type of risk that is co-essential to the insurance business. Also in light of the provisions of Article 19 of IVASS Regulation No. 38/2018, IVASS expects this risk to be integrated into the corporate risk management system and, consequently, into the corporate risk assessment framework, with the consequent definition of the risk appetite itself. As is well known, by their nature compliance and reputational risks do not lend themselves to being adequately monitored by specific capital buffers. IVASS therefore expects the risk assessment framework to specify in detail the measures, present in the undertaking's internal control system, aimed at ensuring the appropriate mitigation of these risks, as they are associated with the POG process. In particular, as regards

the compliance risk, IVASS expects these measures to be suitable for minimising it.

Criteria governing the identification of the target market (TM) and the analyses for determining and measuring the value for money,

5. IVASS expects the target market to be identified with an adequate level of granularity, both with reference to the variables provided for in Article 5 of Delegated Regulation (EU) 2017/2358 and with reference to other elements considered relevant in the assessment.

5.1. The identification of the target market is a crucial step in the definition of products that are compatible with the characteristics, needs and objectives of the customers for whom they are designed (positive target market) or to whom they cannot be sold because they are incompatible (negative target market). The greater level of detail in the characteristics to be considered for IBIPs is also underlined by the specific requirements set forth in Article 6(2 and 3) of IVASS Regulation No. 45/2020. Products with multiple investment options (Multi-Option Products, hereafter MOPs) present a higher level of complexity and consumer choice. For such products, the identification of extremely broad target markets increases the risks of misselling related both to understanding the product and to its compliance with the characteristics, needs, objectives and risk profile of the potential customer; moreover, in these cases, a target market of limited granularity necessarily requires more advice both in the sale and follow-up phases, with possible consequences in terms of increased costs for customers¹⁰. In fact, the assessment of the level of advice required to sell the product cannot depend on an insufficient level of detail of the target market, but must be justified by the characteristics, needs and objectives of the potential customers, also taking into account the risk profile, complexity and nature of the product. More specifically:

- a. with regard to the “age” variable, it is expected that sufficiently detailed age classes will be identified, which take into consideration the investment/protection needs related to the different life stages of the potential customer;
- b. with regard to the variable “objectives” of the customer, it is expected that the differentiation will not be limited to the mere distinction between “investment” and “savings” objectives, but also include a graduation defined on the basis of expected results. For example, (i) capital preservation, (ii) capital preservation and growth; (iii) growth; each objective will be associated with the expected performance range of the target market in order to assess whether or not it is in line with that of the product; (iv) protection against biometric risk. Differentiation should also take into account other possible objectives, such as obtaining an annuity when reaching retirement age;

¹⁰ For instance, by increasing the explicit or implicit loadings on the premium.

- c. the different variables subject to the product testing (e.g. ability to bear losses, risk appetite, time horizon) are expected to be evaluated in relation to the specific product (so-called “product approach”), as required by the European regulations applicable to the insurance sector and not only with the logic of the customer’s overall investment portfolio (MIFID-derived “portfolio approach”);
- d. the degree of granularity of the target market is expected to take into account the complexity of the product, in accordance with the link explicitly established by Article 5.1 of Delegated Regulation (EU) 2017/2358 on POG and as suggested by recital 6 of the same Regulation, according to which, for more complex products or less common products, the target market should be identified with more detail taking into account the highest risk of consumer detriment associated with such products.

6. IVASS expects that the undertaking identifies a sufficiently graded complexity scale on which to place IBIPs and that the placement of the product on the scale takes into account its characteristics and comprehensibility to the customer.

6.1. IVASS expects the undertaking to identify and formalise its own notion of complexity of the IBIP, bearing in mind that this concept relates to aspects linked not only to comprehensibility for the customer, but also to the structure and functioning of the product, its characteristics, the underlying assets, and the link between the assets and the value of the benefits.

6.2. IVASS expects the complexity scale to be sufficiently graduated (e.g. minimum/low/medium/high) and not to result in a simple binary formulation of complex/non-complex product adopted pursuant to Article 16 of Delegated Regulation (EU) No. 2017/2359 for the identification of products for which IVASS regulations do or do not require mandatory advice (pursuant to Article 68-*duodecies* of IVASS Regulation No. 40/2018).

In the context of IVASS’s supervisory activity, it has been observed that there are numerous MOPs on the Italian market (which provide both schemes with a free choice by the customer of the investment option in individual funds and schemes identified on the basis of predetermined percentages/combinations¹¹ of investment allocation) characterised by an extremely large number of options, in some cases several hundred. Due to their large number, these products are often characterised by an extremely general and broad target market, and a more precise identification of this target market is usually left to the distributor.

¹¹ For example, investment assumptions according to predefined percentages in specific funds or in separately managed accounts and funds.

7. In the case of products with multiple investment options (MOPs), IVASS expects the number of options to be critically assessed and the definition of the target market to be carried out for predefined combinations of options that reflect the segmentation of the target market.

- 7.1. With reference to these products, including in light of the provisions of paragraph 3.11 of the EIOPA Statement¹², IVASS expects:
- a. the number of investment options to be consistent with the undertaking's ability to ensure adequate analysis and monitoring of the main combinations of options;
 - b. the number and quality of the proposed investment options to be carefully evaluated in light of the level of knowledge and experience of the target market for which the options are intended. The different options should be differentiated by their responsiveness to the needs, characteristics and objectives of specific and uniquely identified target markets. A large number of similar options responding to the same target market could increase the complexity of the product without providing any real benefits for the customer;
 - c. the target market to be defined, where appropriate, at least with reference to each standard combination of the most significant investment options, so as to ensure adequate granularity. In particular, with reference to MOPs that provide for a wide range of underlying options with different levels of risk, the identification of predetermined "risk profiles" (and, therefore, of specific target markets associated with predefined combinations of options) helps reduce both the complexity of the product and the risk of an incorrect sales process to the detriment of the customer.

8. IVASS expects the product testing activities conducted as part of the POG process (aimed at assessing the generation of adequate value for money and thus the compatibility of costs and charges with the needs, objectives and characteristics of the target market) to be carried out in a manner distinct from - but consistent with - the undertaking-side sustainability and profitability analyses.

- 8.1. In the process of designing and approving a product, both profitability/sustainability analyses for the undertaking and product testing activities from the customer's point of view should be carried out, in accordance with POG regulations. However, the two types of activities respond to different and potentially conflicting objectives: the first aims to verify the consistency of the product with the undertaking's profitability

¹² "A multitude of options in terms of underlying funds, levels of capital guarantees, and insurance features bring more choice for customers. This, however, increases the complexity of a product and thereby raises the level of advice required as well as the time and literacy required by the customer to make a well-informed decision. Therefore, it is important that differing options adequately reflect different needs, objectives and characteristics of customers belonging to the target market and that these aspects are also taken into account in defining a sufficiently adequate distribution strategy which aims at mitigating possible risks for customers."

targets, including risk-adjusted targets; the second is aimed to assess, inter alia, that the amount of costs and charges is compatible with the needs, objectives and characteristics of the target market, and is such as to allow adequate value for the customer.

8.2. As part of the product approval process, IVASS expects the product testing activities carried out within the POG framework to be separate from, but conducted simultaneously and consistent with, the sustainability and profitability analyses of the product from the undertaking's side, avoiding in particular that the former becomes subordinate to the latter.

9. IVASS expects the product testing activity to be:

- a. defined and developed in a manner consistent with the granularity of the target market and based on realistic data, as closely in line with the undertaking's portfolio as possible;**
- b. formally defined in detail and provide for metrics and thresholds which, if not met, are followed up by appropriate corrective action (escalation, modification or non-approval of the product);**
- c. executed in a traceable manner.**

With regard to the aforementioned expectations, it should be noted that the supervisory activities carried out by IVASS both on-and off-site consist of checks on various aspects of product testing activities. In particular, IVASS verifies that they:

- i. are carried out by grouping potential customers into sufficiently granular clusters, consistent with the variables identifying the target market assessed as relevant (e.g. in terms of age, amount of premiums, any supplementary insurance coverage selected, investment time horizon, financial knowledge, etc.);
- ii. are based on realistic information and data, consistent with those of its own portfolio/experience on similar products (characteristics of the policyholders/insureds, riskiness and objectives of the selected investment options, investment horizons chosen, surrender frequencies, use of supplementary insurance coverages, and so forth). The use of market data should be limited to cases where an adequate internal and/or group information base is not available;
- iii. in line with the provisions of paragraph 4, follow a clear methodology, described in the policy or in a document annexed thereto, which is made available to the stakeholders involved in the POG process for its implementation and related controls.

The methodology identifies criteria, measurement and judgement metrics for each analysis and, where relevant, weights to be assigned to the drivers of the analyses. In addition, it identifies thresholds in the analysis that result in actions or decisions that are relevant for the process, including the decision not to market a product with an inadequate value for the customer. The identification of thresholds helps to concretise the analysis and to define possible actions or decisions ex ante, facilitating a smooth process.

Criteria, metrics, weights and thresholds identified in the methodology are determined, justified and tested in line with the objectives, needs and characteristics of the target market for which the product under examination is intended;

- iv. are formalised in their execution, in such a way as to ensure the preservation of the data and information used for the evaluation, as well as the justifications underlying the judgements made or any changes made as a result of the outcome of the analyses;
- v. where product testing activities also take into account analyses based on comparisons with similar products on the market (peer group), IVASS's checks also include:
 - the level of contribution (which we do not expected to be significant) of these analyses to the formation of the overall judgement;
 - the criteria for the creation of peer groups, which are expected to be sufficiently articulated;
 - the activity conducted to assess the homogeneity and statistical representativeness of the peer groups. In the case of IBIPs linked to UCITS or internal funds¹³, compliance with these criteria for the financial component entails the inclusion in the peer group of substitute investment products (i.e. other than insurance products).

10. IVASS expects the implementation of a customer-side profit test to play a central role in product testing, which jointly considers returns, the costs borne by the customer during the developing of the product over time and, where relevant, the impact of inflation. With regard to MOPs, IVASS also expects the profit test to be developed by considering combinations of different investment options (see point 7).

- 10.1 IVASS expects product testing activities to focus on the customer's perspective and to include (with a central role) a customer-side profit test, i.e. a development of all flows generated by the product throughout its life cycle in terms of premiums, benefits and costs in order to measure, through appropriate indicators, the value of the product for the customer. This measurement should lead to the determination of the product's performance for the customer net of costs, the expected benefit in the case of occurrence of a biometric risk event, and the incidence of costs over the product's various significant time horizons. Similarly, IVASS expects the product riskiness component, if taken into account, to be always assessed in the customer-side profit test analysis together with the expected profitability.
- 10.2 IVASS expects the customer-side profit test evaluations to be carried out on customer profiles and data consistent with the indications in (i) and (ii) above underlying Expectation No. 9. With particular regard to MOPs,

¹³ Class III or hybrid, for the non-profit component.

profit test analyses are also expected to consider combinations of investment options deemed significant for the definition of the relevant target market. Evaluations should also include multiple customer profiles calibrated to the variables relevant to the customer as well as appropriate stress assumptions, including in relation to financial scenarios, in order to verify the trend and resilience of performance and cost indicators under varying assumptions.

11. IVASS expects:

- a. pursuant to Article 8 of IVASS Regulation No. 45/2020, the customer-side profit test to lead to a value of the product that is adequate for the customer, i.e. in line with the characteristics of the target market, its return expectations and needs, in the absence of which appropriate measures should be taken, including the non-marketing of the product;**
- b. the indicators used in the customer-side profit test to be in line with the purposes assigned to the more general product testing activity by Article 8 of IVASS Regulation No. 45/2020¹⁴.**

11.1 In line with the EIOPA methodology¹⁵, IVASS expects the value of several indicators to be determined in the customer-side profit test evaluations, including:

- a) the customer's expected internal rate of return, net of costs, under both expected and adverse market scenarios, to assess the impact of stressed market conditions on the performance for the customer;
- b) the ratio between the surrender value and the amount of premiums paid;
- c) the expected reduction in yield expressed on an annual basis due to the effect of all the contract costs¹⁶ borne by the customer (RIY);
- d) the ratio between the total value of the costs incurred and the premiums paid and between the total value of the costs incurred and the benefit paid to the customer;

¹⁴ "Paragraph 1: [...] manufacturers assess the costs and charges to be applied to the insurance product by examining, inter alia, the following elements: (a) that the amount of the costs and charges is compatible with the needs, objectives and characteristics of the target market and such as to allow adequate value for the customer; (b) that the structure of costs and charges is adequately transparent to the target market, does not conceal costs and charges and is not too complex to understand. Paragraph 2: with specific reference to insurance-based investment products, manufacturers also establish: (a) that the costs and charges do not undermine the return expectations of the insurance-based investment product; (b) whether the insurance-based investment product may pose a threat to the proper functioning or stability of financial markets and the insurance market or to the protection of insureds or to the integrity and orderly functioning of markets. 3. Where relevant to the product characteristics, manufacturers conduct a scenario analysis to assess the risk of the insurance-based investment product producing negative results for end customers and under what circumstances this may occur. For this purpose, the insurance-based investment product is evaluated at least in the light of the following negative circumstances: (a) a deterioration in the market environment; (b) financial difficulties of the manufacturer or third parties involved in the manufacturing and/or operation of the insurance-based investment product or the occurrence of a high counterparty risk; (c) the non-sustainability of the insurance-based investment product from a commercial point of view".

¹⁵ EIOPA Methodology to assess value for money in the unit-linked market of 31 October 2022 (https://www.eiopa.europa.eu/document-library/methodology/methodology-assess-value-money-unit-linked-market_en?source=search).

¹⁶ Including entry costs, recurrent costs (such as management commissions), ancillary costs and exit costs.

- e) the ratio of acquisition costs to the total value of the costs incurred;
- f) the break-even point (i.e. the point at which the benefit accrued by the customer equals the value of the premiums paid);
- g) the minimum average yearly return of the product underlying assets required to reach the break-even point at the RHP and/or over time horizons that are relevant for the product (see Section 11.2 below);
- h) the ratio between the benefit paid if the insured event occurs and the amount of premiums paid;
- i) the ratio between the premium for biometric risk coverage calculated using the best estimate assumptions applied for determining Solvency II technical provisions and the premium paid by the customer for the insured biometric benefit.

11.2 IVASS expects the valuations referred to in the preceding point, with the exception of that under f), to be carried out not only at the RHP¹⁷ or at maturity, but also over other relevant investment time horizons based on the characteristics of the target market, such as RHP/2, as well as for products with a long maturity, at the time of the probable surrender assessed on the basis of its own portfolio statistics; for example, with particular reference to long-term products (with a RHP of more than 15¹⁸ years), there is a greater need to take into account the liquidity needs of customers that may change over time. Therefore, the expected permanence in the contract based on one's own portfolio statistics should be considered in the evaluations.

11.3 In addition to the indicators mentioned in Section 11.1, IVASS expects the incidence of surrender penalties on the surrender value to be measured in line with the EIOPA methodology.

11.4 With particular reference to the indicator mentioned in the previous point, it would be useful to measure it not only at the annual period preceding the RHP as provided for by the EIOPA methodology, but also at RHP/2 and, for long-term products, at the time of the presumed surrender, at any rate carrying out at least an assessment at the end of the 8th annual contract period if, on the basis of the statistics of one's own portfolio, the time of the presumed surrender is later. This provision, as pointed out in Section 11.2, makes it possible to take into account the different needs of customers, which may vary over a long period of time.

11.5 IVASS also generally expects the RHP to be set in relation to maximising the product's return prospects for the customer and not on the basis of other considerations such as, for example, the termination of any

¹⁷ *Recommended Holding Period.*

¹⁸ The average recommended holding period for IBIPs marketed in Italy is 8.6 years. Products with a RHP longer than 10 years account for less than 15% of the products on the market. SOURCE: Statistical Bulletin Year IX - No. 12, December 2022.

surrender penalties; in other words, it should not coincide merely with the moment when a possible termination by surrender would no longer incur penalties.

11.6 In line with point (iii) underlying Expectation No. 9, for the indicators referred to in Section 11.1, IVASS expects significant thresholds to be identified and formalised leading to actions/decisions that are relevant for the process, including the decision not to market a product with no or very little value for the customer. With special regard to the thresholds and criteria for assessing the results of the customer-side profit test, IVASS expects:

- a. the analyses to be aimed not only at verifying that cost recovery occurs within a certain time horizon, but also that a positive result in line with the product's risk profile is achieved;
- b. a balanced allocation between the undertaking and the customer of the return generated by the product (i.e. between the net return recognised to the customer, on the one hand, and the costs and charges of the product, on the other), such that the return expectations of the insurance-based investment product, consistent with its risk profile, are not compromised. For example, a product whose expected gross return at the RHP is 6% and the net return recognised to the customer is 2% does not, in principle, ensure compliance with the regulatory requirement. In any case, IVASS expects the POG policy to contain the methodological indications aimed at fully defining the logic through which the undertaking determines the sustainability (on the customer side) of a product in relation to the cost structure, appropriately distinguishing between volatility products and benchmark products;
- c. especially for long-term products, and always taking into account the expectations of the identified target market, the return to be analysed also in real terms, taking account of the effects of inflation;
- d. an assessment to be carried out of whether the charges applied to the premium covering the biometric risk are fair in relation to the actuarial assumptions;
- e. cost recovery for the customer to take place within a reasonable time, and in any case taking into account the characteristics of the target market; therefore, the break-even point should be assessed by taking into account the expected permanence in the contract based on one's own portfolio statistics. If, for example, customer-side profit test evaluations show that the break-even point is expected to be achieved at year 10, and portfolio experience data, on the other hand, indicate an average permanence in the contract of 6 years, this would imply that most customers would not even recover the premiums paid at the time of probable surrender;

- f. the insurance features of the product to be taken into account in their various components and considered in relation to the needs of the target market: as an example, the recognition of a loyalty bonus in the last years of a contract with a very long duration (e.g. 15/20 years) would not be of real value to the customer if experience data on the average permanence in the contract indicates that most customers surrender the policy after 8/10 years;
- g. the level of acquisition costs, generally applied at underwriting or in the first few years after underwriting (with a consequent reduction in the premiums invested and a significant impact on the profitability of the product) to be not high as this would require a long permanence in the contract in order to achieve minimum profitability targets, to the detriment of the customer. IVASS also expects the test to include an assessment of the impact that a possible practice of collecting commission in advance in favour of the distributor may have on the customer.

12.IVASS expects the product testing activity to include a qualitative component of limited weight, in which: (a) only the elements that meet the needs of the target market are taken into account; (b) the technical characteristics of the product already considered in the quantitative analysis are not considered again, thereby avoiding a double valuation of the same characteristic.

- 12.1. In the product testing activity, IVASS expects that the qualitative tests do not to consist of mere checklists designed to verify formal compliance with the process steps, but of analyses and evaluations in which the judgement assigned to each test, as well as the overall judgement, are adequately justified and expressed on the basis of the criteria and procedures for assigning the judgement formalised according to the criteria in point iii) underlying Expectation No. 9.
- 12.2. IVASS expects only elements linked to product features/mechanisms (such as digital services, sustainability (Environmental, Social and Governance; ESG) features of the product, the possibility to activate voluntary switches) to be included in the qualitative assessment, and not also general elements unrelated to them, such as those concerning, for example, the level of consumer confidence in the brand or the solvency of the issuing insurance undertaking.
- 12.3. IVASS expects the selected characteristics to correspond to the needs of the customers belonging to the target market and, therefore, their presence and weight to be properly considered in relation to the different customer profiles. For example, it would not be in line with the expectations of IVASS to consider a mere counter of the number of elements taken into

account, which could also include aspects not of interest to the customer belonging to that market, as in the case of:

- a. the presence of scheduled surrenders, automatic switches from separately managed accounts to unit funds and vice versa for hybrid contracts, especially in relation to a target market with little awareness of the flexibility associated with this type of options;
- b. the possibility to activate voluntary switches, which may have added value for target customers with medium to high levels of financial investment knowledge and experience, but may not represent similar value for target customers with low financial knowledge and experience, who are probably less likely to activate it;
- c. the presence of digitisation services or ESG features of the product in relation to a target market that is not interested in or has little awareness of these aspects.

13. IVASS expects:

- a. **the product testing activity to be concluded with a final judgement determined by an evaluation system that appropriately integrates the results of the various analyses carried out;**
- b. **quantitative analyses to have a prominent weight in the final judgement, including with the application of blocking thresholds on the most significant variables.**

13.1. IVASS expects the various analyses conducted to be coherently integrated into a single evaluation system leading to a final result that expresses the judgement on the value of the product for the customer. In this way, the presence of several types of analysis/drivers focusing on different aspects of the product or different customer needs finds the necessary final synthesis on the effective correspondence of the product, in its uniqueness, to the needs, characteristics and objectives of the target market. To this end, the different stages of the process leading to the determination of the final judgement on the product must be defined and formalised (methods of aggregating the results of the different analyses/drivers, weights attributed, possible priority/blocking relevance of certain analyses, possibility of derogation and escalation process).

14. IVASS expects the monitoring and review activities of the product to be carried out with a methodology consistent with that used in the product testing phase in order to verify that the product still meets the objectives characteristics, and needs of the target market for which it was designed, taking into account the experience gained on the product with respect to pre-market evaluations.

14.1. IVASS expects the monitoring and review of IBIPs carried out pursuant to Article 9 of IVASS Regulation No. 45/2020:

- a. to be implemented at least once a year and, where appropriate, upon the occurrence of an event relevant to the product or to the target market, as defined in the POG policy;
- b. to be conducted out according to a methodology consistent with that used in the product testing phase, with the aim of verifying whether the same tests carried out during the launch phase continue to indicate that the product still meets the characteristics, needs and objectives of the target market for which it was designed. In particular, for each investment option IVASS expects the performance of the underlying assets, costs, risk and RHP indicator to be tested in order to verify that, over the recommended investment horizon, the contract will continue to meet the needs and risk/return expectations stated at the time the contract was entered into;
- c. to be conducted on the basis of the granularity of the identified target market and, for MOPs, also on the basis of the different combinations of investment options;
- d. to be based on realistic data consistent with the actual characteristics of its portfolio, also taking into account, where not already provided for in the product testing phase, information and data on quantities relevant to the life of the contract, including actual surrenders in the various years from the conclusion of the contract, terminations, non-completion of the contracts, lapse rate of recurring premiums, additional premium payments, selected investment options, complaints, and, of course, reports received from distributors. For these indicators, too, IVASS expects criteria and metrics to be identified and formalised, as well as thresholds that trigger actions and decisions relevant to the process, including the decision to change the product characteristics and to suspend or cease its marketing to all or part of the target market.

14.2. In the event that significant action is taken as a result of the product monitoring activities, including, for example, the termination of the marketing, IVASS expects the undertaking to consider taking measures to protect customers who have already subscribed to the product and who have suffered a detriment.

15. IVASS expects the undertaking to conduct a periodic review of the IBIPs in its portfolio, regardless of the date on which they began to be marketed.

- 15.1. In order to ensure adequate protection for customers, IVASS considers it essential that the undertaking's products be subject to periodic review, in accordance to the different situations. In this regard IVASS expects that:
- a. in relation to products issued after 1 October 2018 and fully subject to the POG rules, the undertaking provides a definition of "significant change" that is functional to the characteristics of the product, also considering the characteristics of the target market;
 - b. for products issued before 1 October 2018 and still on the market, the undertaking provides a definition of "significant change" functional to the

characteristics of the product, also considering the characteristics of the target market. In such cases, the POG rules for products issued after 1 October 2018 will apply to the product;

- c. even if there is no significant change, the undertaking conducts periodic reviews consistent with the proportionality principle and aimed at verifying that the product continues to meet the needs of the customers to whom it is offered.