IVASS: TOWARD A *CONSUMER CENTRIC* INSURANCE

SESSION 03: Sharing national supervisory experience

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Introduction

BaFin acts as prudential + conduct supervisor (SII-Directive + IDD)

Conduct of business (CoB) supervision according to IDD is relatively new for the German market; esp. Product Oversight and Governance (POG)

Value for money (VfM) of insurance based investment products (IBIPs) and similar saving products is a priority of BaFin's conduct supervision because:

- Around 50 life insurers offering such products with BaFin as home NCA ⇒ key products in the German life market

- 2.5 million new contracts in 2022 (1.4 million unit-linked IBIPs)

- BaFin stipulates that customers are offered products with appropriate VfM !

BaFin's focus in conduct supervision of IBIPs (I)

BaFin's Guidance Notice 01/2023, recitals 15 & 18:

- *„When assessing the value for money of savings products [esp. unit-linked], life insurers must formulate return targets, taking into account … external factors (such as capital market conditions); these targets must be in line with the expectations of the target market they have determined."*

- *„As product manufacturers, life insurers are required to assess the interaction of the variables "costs" and "return" (before costs) as part of their product testing. From the policyholder's point of view, the higher the costs, the higher the risk of an insufficient (or even negative) return under otherwise similar framework conditions. The costs of the product, on the other hand, are a variable that can be influenced by insurers in the context of product manufacturing more extensively than the return … . A suitable indicator for assessing the total costs of a savings product is the reduction in yield [RIY] … ."*

BaFin‘s focus in conduct supervision of IBIPs (II)

Supervisory Point of Departure:
IBIPs serve the customers as private old-age provision - typical product: Regular premium & recommended holding period (RHP) of more than 30 years (unit-linked / hybrid IBIPs dominating new business).

Supervisory Observation:
A high number of customers terminate their contracts before the end of the RHP - based on a lapse ratio of 3,36% in unit-linked insurance (in the average of the years 2018 -2022). Due to upfront costs (typical for the German market) these customers suffer even more from high costs (RIY) affecting the return.

Supervisory Expectation to Market:
If it can be expected for the target market of a product that a significant proportion of the members of the target market will surrender their contracts prior to the end of the RHP this <u>must</u> be taken into account in the assessment of the VfM. It will not be sufficient to take only the end of the contractual savings phase as a basis for the determination of VfM.

Risk based supervisory approach and risk indicators

Guidance Notice 01/2023 – aim: to prevent and identify outliers

Risk indicators are based on data for the German life insurance industry as a whole (as benchmark – 75%-quantile) + data on the level of the individual undertaking

- RIY (most sold products / product combinations) ⇒ surveys by BaFin
  benchmark for typical unit-linked product; RHP 30 years: 2,35 % (= 75%-quantile)
- Remuneration & other expenses for intermediaries ⇒ surveys by BaFin
- New business & early surrenders in relation to contracts ⇒ regular reporting to BaFin
- Acquisition & administration costs / earned premiums ⇒ regular reporting to BaFin
- Performance of funds (units) ⇒ regular reporting to BaFin

Initial experiences and perspective

Insurers' reaction to Guidance Notice shows the importance/relevance of supervisory guidance as legal provisions are very abstract *(supervisory expectation)*.

Even though higher costs can be (over-)compensated by higher returns the assessment of costs is an essential element of product testing as part of POG.

Setting (and publishing) of benchmarks has a positive effect on the market
- so far encouragement to reduce costs.

Following to its risk based approach BaFin identified 6 insurers in 2023 and 4 insurers for 2024 to be assessed more closely (+ 3 insurers in 2022/development phase of supervisory approach).

Expectation: market participants will obey new BaFin Guidance Notice.

Thank you for your attention!

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