



FSMA_2016_15 of 15/09/2016

Communication on reporting about transactions in unit-linked insurance products

Scope:

This communication concerns insurance companies selling life insurance contracts linked to one or several investment funds and whose commitment is situated in Belgium.

Summary/Objectives:

The FSMA has conducted a sectoral study of the quality of the reports prepared pursuant to Article 73 of the Royal Decree of 14 November 2003 on life insurance activities for each investment fund sold via a class 23 insurance contract. A number of important conclusions can be drawn from the study.

This Communication is intended chiefly to remind insurance companies of their obligations in this regard and, where necessary, to clarify the regulations. The Communication also contains a number of recommendations intended to improve the quality and the availability of the reports.

Structure:

- I. Introduction
- II. Obligations laid down in Article 73 of the Royal Decree on Life Insurance
 - a. Form of the reports and the way they are made available
 - b. Content of the reports
- III. Conclusion

I. Introduction

Pursuant to Article 73 of the Royal Decree of 14 November 2003 on life insurance activities (hereafter "the Royal Decree on Life Insurance"), Belgian and foreign insurance companies must prepare an annual and a half-yearly report for each Class 23 investment fund sold via an insurance contract whose commitment is situated in Belgium. A Class 23 investment fund (hereafter "investment fund") is understood in this Communication to mean an internal insurance fund that is the underlying of an insurance contract. The investment fund in turn invests in assets such as shares, bonds, units of UCIs, etc., in order to achieve a certain yield.

The reports referred to here are prepared in order to provide the policyholders with current financial and other information regarding the investment fund(s) linked to their insurance contract. They must be made available to the policyholders at the registered office of the insurance company.

The FSMA has conducted a study of these reports. A number of important conclusions can be drawn from the study:

1. certain insurance companies do not prepare any reports as required by the Royal Decree on Life Insurance¹;
2. various provisions of Article 73 of the Royal Decree on Life Insurance have, sometimes because of an erroneous understanding of the regulations, been complied with only partially or not at all;
3. the public is often unaware of the existence of these reports. Due to the limited distribution of the reports, a significant source of information about their investments is withheld from policyholders.

This Communication is intended chiefly to remind insurance companies of their obligations in this regard and, where necessary, to clarify the regulations. The Communication also contains a number of recommendations intended to improve the quality and the availability of the reports.

II. The obligations laid down in Article 73 of the Royal Decree on Life Insurance

A. Form of the reports and the way they are made available

i. Form of the reports

In accordance with Article 73, § 1 of the Royal Decree on Life Insurance, a report must be prepared for each investment fund.

It is common practice in the sector, however, to link a single insurance contract to several investment funds but to prepare a single report for the policyholders with an overview of all the different investment funds that may underlie the contract.

This practice is contrary to the provision of the aforementioned Article 73, § 1; the report must be specific to each investment fund.

The frequent practice of making available only the report for the UCI or other financial instrument underlying the investment fund is likewise insufficient, even if the investment fund invests in just one underlying UCI or other instrument. The reason is that many investment funds hold considerable cash positions in addition to their investment in a UCI, for example, and this has a significant impact on the spread of assets in the investment fund as well as on the yield and the risks of the investment fund. These aspects are not covered if one looks only at the report on the underlying UCI.

Finally, it should be emphasized that the report in question cannot be replaced by the publication of other information such as monthly or quarterly information sheets, financial infosheets, market analysis, etc. Such documents contain valuable information but cannot replace the reports. The content of the aforementioned documents do not fulfil the minimum requirements of Article 73.

¹ In just one instance, this was due to the fact that the company was unaware of the existence of Article 73. In the other cases, the companies assumed - incorrectly - that they fulfilled the obligation laid down in Article 73 by making available information sheets, fact sheets, quarterly reports, etc.

Moreover, such documents are issued irregularly or at intervals that are different from those of the periodic reporting, and thus do not provide the policyholder with a constant and uniform picture of his or her investment.

ii. Making the reports available

As regards the availability of the reports, Article 73, § 1 of the Royal Decree on Life Insurance provides only that the reports must be made available at the registered office of the insurance company. With a view to a broader distribution of information that is useful to policyholders, the FSMA recommends that the reports also be published on the company's website.

B. Contents of the reports

i. Composition of the investment fund

In accordance with Article 73, § 3, 1° of the Royal Decree on Life Insurance, the composition of the investment fund must be given in amounts and in percentages, based on a breakdown into eight categories. It goes without saying that the reports in question must contain a clear summary of the investments in the investment fund.

The assets of the investment fund are usually invested in one or more UCIs or similar collective investment instruments. If the investment fund invests in UCIs, the name of those UCIs and their legal status (UCITS or AIF) must always be mentioned.

However, in the FSMA's view such a mention does not suffice to fulfil the aim of Article 73, § 3, 1° as mentioned above.

The aforementioned underlying UCIs or other instruments in turn invest in a diversified portfolio of assets or in a portfolio, diversified or not, of UCIs or other investment vehicles that may themselves invest in an underlying diversified portfolio.

It is that underlying portfolio that constitutes the actual investment for the policyholder.

If the insurance company reports only on the composition of the portfolio at the "first level" (usually an investment in a UCI, though sometimes investments directly in assets are held as well), this means that in many cases the portfolio description will consist of just a few lines, namely, the mention of one or more UCIs.

In order to fulfil the requirements of the above-mentioned provision in a more meaningful way, the FSMA recommends that in addition to mentioning the "first level" of investment, namely, the UCI or other vehicle underlying the investment fund, relevant information should also be provided about the portfolio of those underlying instruments. In this type of "layered" structure, it is not easy for the investor to identify in a clear and straightforward way the nature and characteristics of his or her investment and to assess correctly the associated risks.

Thus, following the manner of presentation proposed in Article 73, § 3, 1° of the Royal Decree on Life Insurance, one can opt to disclose the composition and allocation of the portfolio at the underlying level via the "look-through" principle, while also making it clear to the policyholder that the

investment fund does not hold shares directly in the assets in question but rather via an investment in UCIs or other instruments.

ii. Composition of the asset portfolio

The asset portfolio must, in accordance with Article 73, § 3, 3° of the Royal Decree on Life Insurance, be broken down based on the benchmarks that are most appropriate for the investment fund's investment policy, and based on a certain percentage share in the net assets. The movements in the composition of the securities portfolio during the reporting period must also be included.

In practice, it is often only the entry and exit amounts from the investment fund that are mentioned, along with the resulting purchase and sale of units in the underlying UCIs.

In order to obtain a clear and up-to-date image of the securities portfolio at the end of the reporting period, a list of the movements in the portfolio of the investment fund must first be drawn up. Thereafter it is advisable to report, using graphs and tables among other things, on the current composition of the underlying portfolio, broken down according to the relevant geographical, monetary, sectoral, qualitative (such as regarding sustainability), etc., criteria.

iii. Transactions in derivative products or foreign currencies

In accordance with Article 73, § 3, 5° of the Royal Decree on Life Insurance, the amount of liabilities arising from transactions in derivative products or in foreign currencies must be included in the reports. From our review of the reports, it appears that this information is often lacking.

A frequent inaccuracy in such reports, certainly in the case of investment funds that have a "one to one" ratio and thus invest exclusively in a single underlying financial instrument, is that the amount of the liabilities of the underlying UCI or financial instrument is reproduced in full. Given that an investment fund is rarely the sole shareholder in the underlying UCI, this manner of presentation gives an erroneous image of the liabilities of the investment fund. The amount of liabilities of the investment fund must instead be given taking into account the percentage share of the investment fund in the underlying UCI or financial instrument.

As regards the liabilities arising from transactions in foreign currencies, it is recommended to include these at the exchange rate in effect at the time of reporting.

iv. Summary of the fund's investment goals

The description of the fund's investment goals, as referred to in Article 73, § 3, 7° of the Royal Decree on Life Insurance, must focus on the investment fund's individual investment policy. We noted that often what was provided was a blend (or sometimes simply a "cut and paste") of the investment policies of the UCIs or financial instruments underlying the investment fund, in which the various components were simply listed one after the other.

Under this practice, the investment policy of the investment fund itself is not included in the report. An investment fund's investment policy is in practice implemented by, among other things, the weighting of the underlying financial instruments. In that case, the composition of the investment fund's portfolio will differ from the portfolio composition described in the documentation of the underlying instruments.

The FSMA thus recommends that on this point as well, the workings of the investment fund be set out clearly.

First, it should be made clear that by signing an insurance contract, the policyholder acquires a share in the investment fund. Next, an explanation should be given of the way in which the investment fund puts into practice the investment policy described in the insurance documents. It should also be indicated that because of its layered structure, the investment fund has its own investment policy that is not necessarily identical to the summary of the investment policy or investment goals of the underlying UCIs or other instruments.

v. Description of the risks

The report must also, pursuant to Article 73, § 3, 8° of the Royal Decree on Life Insurance, contain a description of the risks inherent in the investment policy, in the long-term investments in real estate and in the listing of shares.

It is not necessary to identify and describe all potential risks. Only the risks relevant to the investment fund must be included. The description of the risks must be "fund specific" and thus take into account the specific characteristics and composition of each investment fund.

It should also be mentioned in this regard that it may be insufficient to include all the risks mentioned in the prospectus for the underlying instruments. As described above, it may be that due to the different weightings of the various underlying instruments, the investment fund's risk profile differs significantly from the risk profile suggested by including without distinction all the risks of the underlying instruments.

vi. Changes in the fund's unit value

In accordance with Article 73, § 3, 9° of the Royal Decree on Life Insurance, the report must contain information on changes in the unit value of the investment fund over a sufficiently long period. From our analysis of the reports, it appears that partly because of a lack of specifics in the current legislation, there is little uniformity in the way the historical figures for the investment funds' unit value are presented.

In order to be able to assess the relevance of the period chosen, it is advisable to including the starting date of the investment fund in the reports.

It is also advisable to indicate, where available, the changes in the unit value of the investment fund over the same period as the one for which changes in the unit value of a UCI must be provided. This facilitates comparability of the yields of the various products, and offers greater uniformity between the presentation of yields at the investment fund level on the one hand, and the yields of the underlying UCIs on the other.

III. Conclusion

This Communication provides a concise overview of a few of the most frequent shortcomings and points of concern that the FSMA has identified after a review of the financial reports of a relevant sample of investment funds.

From this overview, it appears that compliance with the legislation governing such reports is inadequate.

After publishing this Communication, the FSMA will continue its efforts to improve the quality of the reports and will check whether the recommendations and comments made herein are taken to heart in the preparation of these types of report. The FSMA will not hesitate to make use of the powers conferred upon it by law in this regard, and in the event of repeated infringements of the legislation will, where appropriate, move to sanction non-compliant insurance companies in order to ensure that Article 73 of the Royal Decree on Life Insurance is fully complied with.