

**Comments Template on  
 Consultation Paper on the proposal for Guidelines under the Insurance  
 Distribution Directive on insurance-based investment products that  
 incorporate a structure which makes it difficult for the customer to  
 understand the risks involved**

**Deadline  
 28 April 2017  
 18:00 CET**

Name of Company:	Association of British Insurers	
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<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> <li>⇒ <u>Do not change the numbering</u> in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool</li> <li>⇒ Leave the last column <u>empty</u>.</li> <li>⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph or a cell, keep the row <u>empty</u>.</li> <li>⇒ Our IT tool does not allow processing of comments which do not refer to the specific numbers below.</li> </ul> <p><b>Please send the completed template, in Word Format, to <a href="mailto:CP-17-001@eiopa.europa.eu">CP-17-001@eiopa.europa.eu</a>.</b></p> <p><b>Our IT tool does not allow processing of any other formats.</b></p> <p>The numbering of the questions refers to the Consultation Paper on the proposal for Guidelines under the Insurance Distribution Directive on insurance-based investment products that incorporate a structure which makes it difficult for the customer to understand the risks involved</p>		
<b>Reference</b>	<b>Comment</b>	
General Comments	<b>About the ABI</b>	

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The Association of British Insurers (ABI) is the leading trade association for insurers and providers of long-term savings. Our 250 members include most household names and specialist providers who contribute £12bn in taxes and manage investments of £1.8 trillion.

**Executive Summary**

The Association of British Insurers (ABI) is concerned with the restrictive approach EIOPA has taken concerning the sale of insurance based investment products (IBIPs) in Consultation Paper 17/001, and with the definition of complex IBIPs in Technical Advice 17/048. We believe that this could have significant adverse effects on the market and limit consumers' access to insurance products that provide long-term investment instruments with reduced risk exposure, by wrongly classifying many IBIPs as complex.

Our main concerns relate to the following:

***Insurance product structures***

We consider that parts of the proposed Guideline 2 of CP 17/001 on 'a structure which makes it difficult for the customer to understand the risks involved', fail to meet the objectives of the IDD as they can be interpreted as focussing on the actuarial processes insurance companies have in place to de-risk their products, instead of examining product features that create risks that are difficult to understand. While insurers use complex procedures, these aim to provide customers with medium and long-term instruments that reduce consumers' risk exposure, making them as predictable as possible. For example, the mechanisms of smoothing may be difficult for the customer to understand, but the concept is

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not, including what this means for how risky a product is.  
Guideline 2, as currently drafted, could restrict consumer choice and access to such products. If contractual conditions are clearly disclosed to customers, including for execution-only sales, the structure of the product should not be difficult to understand, and the product should not be classed as complex.

***Regulatory arbitrage***

Competing product lines should be governed by comparable regulatory provisions to ensure a level playing field. We fear that both the definition of complex IBIPs within the EIOPA Technical Advice and the proposed guidelines in CP 17/001 would fail to achieve this aim. Pooled investment vehicles, such as investments in UCITs funds, are currently afforded favourable regulatory requirements compared with the provisions of the IDD for IBIPs. It should be recognised that IBIPs, such as standard unit linked investment options and with-profits, provide exposure to diversified investment pools in a similar manner to UCITS funds, and aim to smoothen returns and reduce exposure to market volatility. It is important that such investment vehicles have comparable regulatory status.

***Focus on execution-only sales***

The focus of the CP on execution only-sales could restrict innovation in the market, by introducing rigid provisions for insurance product distribution. This goes against the principle of technology neutral regulation. Products should be available through various different channels, and it should be considered that digital distribution of retail financial services plays an important role in this respect. Buying products on-line should not be made unnecessarily burdensome for

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providers against rapidly increasing demand for such services.  
We are concerned that under the current proposals, the vast majority of IBIPs are likely to be classed as complex. This means that even consumers with high financial capability who take the initiative to make their own investment decisions will be forced to undergo an appropriateness test. Furthermore, even if a product was classed as non-complex, it could not be sold without an appropriateness test if the sale was not explicitly at the customer's initiative.

***Existing regulation***

Insurers are heavily regulated entities. Solvency II, the Financial Services Compensation Scheme and existing product oversight and governance requirements ensure the safeguarding of consumers' interests and investments. There are extensive disclosure requirements in place to ensure that consumers are provided with necessary documents, such as the PRIIPs KID, which present information about risks and complexity of products. Furthermore, the recent change to the PRIIPs comprehension alert makes an explicit link to the IDD. We believe that EIOPA has not taken these provisions sufficiently into account when opting for an approach which will significantly change the distribution landscape for IBIPs.

***Uncertainty for providers***

Our members lack certainty on a number of issues, and we would welcome clarification from EIOPA that closed business and contracts concluded before the IDD comes into force on 23 February 2018 should not be covered by the Directive, or the proposals of CP17/001. This should extend to instances where contractual

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	<p>options are exercised by the customer. The IDD clearly concerns the distribution of products, and therefore any products distributed before the Directive coming into force should not be covered by its provisions.</p>	
<p>Question 1</p>	<p>We believe that the Impact Assessment fails to take account of existing regulatory requirements, or that many product features of IBIPs are very familiar to customers. The restrictive approach taken by EIOPA could have adverse effects on the ability of customers to access IBIPs through different sales channels, and on the ability of insurers to innovate, as it would likely render most execution-only sales of IBIPs impossible. Furthermore, it might restrict the investment options for insurers and limit investments into assets automatically classed as complex, such as infrastructure.</p> <p>We believe that EIOPA focusses excessively on the execution-only sales journey without taking into account the many different safeguards in place to protect and disclose information to consumers. These include:</p> <ul style="list-style-type: none"> <li>• Product oversight and governance (POG) arrangements: The IDD puts in place POG requirements, proportionate to how complex and risky a product is. Product manufacturers have to establish appropriate measures in the process of designing, monitoring, reviewing, and distributing products, as well as take necessary action where there is potential for customer detriment. This includes the demands and needs test and mitigation of conflicts of interest. The IDD Technical Advice also sets out clear responsibilities for the manufacturer's management. These POG requirements cover the features of an insurance aspect, including the coverage, costs, risks, target market, compensation and guarantee rights, as well as any personalisation of the product. They also stipulate that manufactures must select distribution channels that are</li> </ul>	

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appropriate for the target market.

- PRIIPs: The PRIIPs KID includes information about how risky a product is, what the product's likely future performance looks like including a stress scenario, and detailed information about costs including how these affect performance. The comprehension alert now makes an explicit link to the IDD, and this change should be considered in the Impact Assessment and reflected upon to ensure a proportionate regulatory approach is chosen.
- Financial Services Compensation Scheme (FSCS): In the UK, insurance and investment firms (and all regulated financial services product providers) are covered by the FSCS. Where a regulated firm defaults, customers may claim compensation from the scheme for lost investments. All ABI members are regulated entities, and the products they sell will be covered by the FSCS.
- Solvency II: Under the prudent person principle insurers may only invest in assets the risks of which they can properly identify, measure, monitor, manage and control. They have to ensure that their corresponding obligations can be fulfilled at all times. So they have to choose carefully the type, scope and quality of the coverage and have to act in the best interests of the policyholders. In addition, all assets must be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole.
- EIOPA Guidelines on System of Governance: Undertakings have to establish an investment risk management policy, in which they establish the level of security that they are aiming for with regard to the whole portfolio of assets and outline how they plan to achieve this. The insurer has to explain in this investment risk management policy that the undertaking assesses the financial

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market environment and takes this into consideration accordingly. In addition, insurers must prepare an internal schedule of investments, which should contain quantitative limits for investments and exposures, including sovereign exposures. The financial market environment should be understood to mean both general conditions as well as current developments and regulatory changes.

The above examples clearly show that insurers are strictly regulated with regards to information disclosure, investment activity, and product design and governance. It is crucial that these are taken into account when assessing complexity of products, as well as structures which make it difficult for customers to understand risks. In particular, the change of the PRIIPs comprehension alert should be reflected in the Impact Assessment.

We hope that EIOPA will establish a proportionate approach and create a level playing field between IBIPs and other financial instruments. To achieve this, it is important that investments made and managed by insurers are not deemed complex. Otherwise, we fear that insurers be forced to invest purely into products deemed non-complex, and might therefore refrain from long-term investments such as infrastructure and other alternative investments. This would limit insurers' ability to provide consumers with products that diversify their risk exposure, make it more difficult to react to changing market conditions, and may obstruct product innovation.

Question 2

As EIOPA correctly notes in its CP, certain customers are interested in receiving execution only services, without considering it necessary to go through a more complex sales journey including questions regarding their financial knowledge and

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experience. Execution-only sales can therefore be a convenient process for customers who have a sufficient knowledge of financial markets and are able to make their own investment choices – as the CP also acknowledges. Furthermore, some of the product mechanisms taken into account by the CP have been common for decades, meaning that consumers are likely to have previous experience of these. It is also crucial to note that consumers may have received advice from a non-regulated financial services provider, such as an accountant.

As the demands and needs of customers are considered in advised, non-advised, and execution-only sales journeys, it is crucial to allow customers with a high level of financial literacy to make their own decisions, and to allow insurers to distribute their products through a range of channels. Consumers increasingly turn to digital channels to purchase goods and services across the UK and the EU. Eurostat<sup>1</sup> shows that 11% of financial services products such as shares and insurance were purchased online, against a background of some 65% of EU internet users shopping online in 2015. Internal analysis by members shows that 44% of customers would prefer to buy insurance and investment products online in the UK, with only 21% preferring not to. These consumer preferences should not be neglected. With the number of online sales increasing year on year, it is therefore vital not to put in place unnecessary restrictions on distribution channels that would limit innovation in this field. As digital distribution evolves, proportionate and technology neutral regulation is necessary to mirror consumer demands, providing for execution-only and non-advised sales.

<sup>1</sup> [http://ec.europa.eu/eurostat/statistics-explained/index.php/E-commerce\\_statistics\\_for\\_individuals#Clothes\\_and\\_sports\\_goods\\_predominate\\_in\\_online\\_purchases](http://ec.europa.eu/eurostat/statistics-explained/index.php/E-commerce_statistics_for_individuals#Clothes_and_sports_goods_predominate_in_online_purchases)



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<p>Question 3</p>	<p>ABI members currently believe that virtually all IBIPs would be caught by either Article 30(3)(a)(i) or Article 30(3)(a)(ii) due to the EIOPA Technical Advice on other non-complex IBIPs, and the proposals within this CP. We explain why we believe this approach is too restrictive with possible adverse effects in our other answers to this Consultation.</p> <p>A main concern is that products which only link to insured funds could still be deemed complex. It is also unlikely that any non-MIFID II financial instruments that are available through an IBIP such as property, deposit accounts (other than structured deposits) and gold etc. would be considered non-complex due to Article 30 (3)(a)(i).</p>	
<p>Question 4</p>	<p>We believe that it is necessary to aim for a level playing field between different regulatory regimes, to ensure that similar and competing financial products are governed by comparable regulatory provisions. To achieve a level playing field between the IDD and MiFID II, Guideline 1 should clarify that it is to be assessed at the level of the underlying fund for products where the customer bears the investment risk and not at product level. Otherwise, this could wrongly classify the majority of IBIPs as complex. Furthermore, focussing this Guideline on the structure of the underlying investment options helps ensure customers understand any associated risks resulting from the way the investment option is structured. We would therefore request that EIOPA clearly explains that Guideline 1 relates to the underlying investment options, not to the product structure.</p> <p>EIOPA should also acknowledge and reflect in its final guidelines that the use of derivatives can facilitate efficient portfolio management and reduce risks. The use of derivatives should not automatically make the product complex and Guideline 1</p>	

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	<p>should be amended to reflect this. Like UCITS funds under MiFID II, funds using derivatives for effective portfolio management should be treated as non-complex. We propose that a further point is added to Guideline 1, stating that:</p> <p style="padding-left: 40px;">‘(d) derivative instruments that contribute to a reduction of risks, or facilitate efficient portfolio management.’</p> <p>Furthermore, we note that if there is exposure to a non-MIFID II financial instrument, it is for the product manufacturer to determine complexity. The ESMA Q&amp;As for MIFID II complexity<sup>2</sup> provide that appropriateness tests are not required for non-MIFID financial instruments such as deposits, loans, mortgages and life insurance policies. Adding reference to this particular principle in Guideline 1 could be helpful.</p> <p><sup>2</sup> <a href="https://www.esma.europa.eu/sites/default/files/library/2015/11/09_559.pdf">https://www.esma.europa.eu/sites/default/files/library/2015/11/09_559.pdf</a></p>	
Question 5	<p>Guideline 2 sets out what should constitute ‘a structure which makes it difficult for the customer to understand the risks involved’. However, large parts of the Guideline could be interpreted as focussing on the actuarial mechanisms insurers use to provide consumers with instruments which diversify risks and smoothen returns. This places an unfair regulatory burden on insurers compared with providers of other financial instruments such as UCITS. Complexity under MIFID II means a high degree of opacity of the connection between the consumer’s investment and the possible risks and returns, for example involving investment strategies with complex derivative instruments to leverage risks, non-transparent exposure to several market risks and / or credit risks. For insurance products, the actuarial mechanisms of the smoothing may be difficult for the customer to understand, but the concept is not, including what this means for how risky a product is.</p>	

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It should be made clear that insurers or intermediaries can clearly explain to the customer whether there are conditions attached to guarantees, or if the insurance undertaking is able to exercise discretion. This would ensure that the structure of the product should not be difficult to understand, including for execution-only sales. We hope that EIOPA clarifies that the Guidelines should not be interpreted as focussing on the actuarial mechanisms in place, and that the existence of discretion or conditions attached to guarantees do not result in the product being deemed complex, as touched upon in point 2.23 of the Consultation.

Specifically, our concerns relate to:

- **Paragraph 2 (a)–(c):** The points listed are linked to conditions to specify complexity of a product, but do not necessarily relate to a structure which makes it difficult to understand the risks. These factors should therefore only be defined in the definition for what constitutes ‘other non-complex insurance-based investments’, as provided by Article 30 (a) of the IDD. Provided that insurers or intermediaries clearly explain the consequences of such conditions to the consumer, such a structure of the product should not be difficult to understand, as point 2.23 of the Consultation acknowledges when it states that ‘the existence of discretion on behalf of the insurance undertaking does not automatically result in the product being deemed complex’.
- Furthermore, we hope that EIOPA clarifies that a contractual clause that offers a customer the possibility to switch between underlying funds is not covered by these provisions, particularly paragraph 2 (a), as it does not allow the insurer to materially alter the nature of the IBIP, but only gives the customer the

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possibility to invest in another underlying fund of the same IBIP.

- **Paragraph 3 (a), and paragraph 3 (a) (i):** Focussing on the provisions of ‘complex mechanisms that determine the maturity or surrender value on death’, or ‘the maturity or surrender value or pay out upon death is dependent on variables set by the insurance undertaking, the effects of which are difficult for the customer to understand’, could be interpreted as implying that any traditional insurance products that may pay discretionary bonuses would be deemed complex. We believe that the focus should be on the outcome for the customer and the actual risks involved, and not on the mechanisms which insurers use. We therefore suggest that these points are deleted.
- **Paragraph 3 (a) (ii):** The provision that ‘the maturity or surrender value or pay out upon death is based on exposure to different types of financial instruments’ could be interpreted as meaning that if insurance investment contained different shares and bonds and the value was derived from the different exposures, the product would be deemed complex. However, this would not be different in nature from a pooled UCITS fund which would qualify as non-complex. We feel that this would put insurance products at a clear disadvantage against comparable financial instruments, and should therefore be deleted.
- **Paragraph 3 (a) (iii):** The point that ‘the maturity or surrender value or pay out upon death may vary frequently or markedly at different points of time over the duration of the contract either because certain pre-determined threshold conditions are met or because certain time-points are reached’, could be interpreted as deeming with-profit type products complex, for example where they guarantee to pay a final bonus on maturity. If contractual dates are clear

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	<p>to the customer at the outset, this would not seem to be a feature that would be difficult to understand. Therefore, we believe this point should be deleted.</p> <ul style="list-style-type: none"> <li>• <b>Paragraph 3 (d):</b> ABI members are currently concerned that the wording of this paragraph could be interpreted to mean that any ‘beneficiary clause’ would be considered as criteria for determining complexity. Beneficiary clauses do not influence how risky a product is, or how it performs. Modifying the beneficiary clause can be in the interests of customers as they enable them to keep control over the beneficiary. This can be easily explained and should not be a factor in this Guideline. We hope that EIOPA explain that it is only very complex contractual provisions of any clause that would deem the product complex, not a beneficiary clause itself.</li> </ul>	
Question 6	<p>We have particular concerns that Guideline 2, read in conjunction with EIOPA Technical Advice specifying other non-complex IBIPs, could wrongly classify many IBIPs as complex. Gabriel Bernardino acknowledged in his address on pensions in Europe<sup>3</sup> from 17 February 2017, that with-profits ‘could allow the pooling of investments with the smoothing of returns across members of the pool, so that all members benefit from average long-term returns of the fund and are protected from extremely negative outcomes in stressed market situations’.</p> <p>We fear that the restrictive approach taken will limit consumers’ access to insurance products, including with-profits, and puts such instruments at a clear disadvantage to comparable financial instruments without any insurance aspects. As currently proposed, it is likely that the vast majority of IBIPs would be classed as complex, therefore rendering execution-only sales nearly impossible – even when the demands and needs of customers are already taken into account. To sell products purely non-advised and advised places rigid requirements on insurers</p>	

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that could limit innovation in the sector, particularly for digital channels. These requirements also go beyond what is necessary to ensure that customers are made aware of complex products, or structures which are difficult to understand. Regulatory requirements for insurers, as explained in answer to Question 1, such as Solvency II, FSCS, existing product oversight and governance requirements, or the PRIIPs KID, already ensure that customers are protected and clearly informed of the underlying risks, likely performance, and costs of a product.

We have specific concerns with regards to the following aspects of the Technical Advice:

- The requirement put in place by Technical Advice (a), for guarantees at both surrender and maturity level, would seem to deem most traditional insurance products that invest in unit linked funds as complex, for example. It also creates an uneven playing field with UCITS, which are automatically classed as non-complex and do not require guarantees, either at maturity or surrender level.

We question why Technical Advice (e) refers to a structure making it difficult for the customer to understand the risks involved, when it is intended to specify 'other non-complex' IBIPs, as of Article 30 (a) (ii). The structure of the product, however, concerns Article 30 (a) (i). Again, it should be highlighted that EIOPA should focus on the ability for the customer to understand how the product is intended to work, rather than the actuarial science involved.

<sup>3</sup> <https://eiopa.europa.eu/Publications/Speeches%20and%20presentations/2017-02-17%20Occupational%20Pensions%20between%20European%20Union%20Rules%20and%20National%20Solutions.pdf>

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Question 7	Please see our answers to the other questions in this Consultation.	
Question 8	<p>We welcome that the CP outlines the decision trees and the examples on IBIPs, as they help to understand the interaction between the requirements in EIOPA's technical advice on 'other non-complex insurance based investments' and the proposals of the CP.</p> <p>We have the following remarks:</p> <ul style="list-style-type: none"> <li>• Example 4: It is not clear why it would be difficult for a customer to understand that below 500 euros investment value the annual management charge is 25 euros. This could be clearly disclosed to the customer.</li> </ul> <p>Examples 9 and 10: The only fundamental difference between the two examples is the existence of a guarantee, which seemingly mitigates the holding of derivatives. UCITS are technically able to hold derivatives, yet they are being classed as non-complex.</p>	
Question 9	<p>We hope that EIOPA will clarify that closed business and contracts concluded before the IDD comes into force on 23 February 2018 are not be covered by the Directive or the proposals of CP17/001, including where contractual options such as top ups or switches are exercised by the customer. The IDD concerns the distribution of products, and therefore any products distributed before the Directive coming into force should not be covered by its provisions.</p> <p>Currently, it is also unclear if a customer would require to go through an appropriateness test, if they held a non-complex IBIP and switched their</p>	

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investment selection to an underlying investment option that would deem the product complex. We believe that it is crucial to specify that products should be assessed at product level.

We hope to be able to provide further product examples to EIOPA in the near future, of IBIPs currently considered to be classed as complex by UK insurers.