



Insurance Undertakings Investment Regulation

(*Versicherungsunternehmen Kapitalanlageverordnung - VU-KAV*)

Full title

Regulation of the Austrian Financial Market Authority (FMA) on quality requirements for investments by insurance and reinsurance undertakings (Austrian Insurance Undertaking Investment Regulation – VU-KAV; *Versicherungsunternehmen Kapitalanlageverordnung*)
Original version: Federal Law Gazette II No. 423/2015

Preamble/Promulgation clause

The following order is made with the consent of the Federal Minister of Finance based on Article 126 of the Insurance Supervision Act 2016 – (VAG 2016; *Versicherungsaufsichtsgesetz*), Federal Law Gazette I No. 34/2015, last amended by the Federal Act, Federal Law Gazette I No. 112/2015:

Text

Section 1

General provisions

Scope of application

Article 1. This regulation applies to insurance undertakings pursuant to Article 5 no. 1 of the Insurance Supervision Act (VAG) 2016 and to reinsurance undertakings pursuant to Article 5 no. 2 VAG 2016 with their registered office in Austria. The provisions of Section 2 apply to insurance undertakings that are required to form a coverage fund (*Deckungsstock*) pursuant to Article 300 VAG 2016.

Asset liability management (ALM)

Article 2. Insurance and reinsurance undertakings must apply appropriate assumptions and factors for the modelling of the ALM in accordance with Article 124 para. 1 no. 3 in conjunction with Article 110 para. 2 no. 2 VAG 2016 and Art. 260 para. 1(b) of the Delegated Regulation (EU) 2015/35 to supplement Directive 2009/138/EC, OJ No. L 12 from 17/01/2015 p. 1.

Policies related to investment

Article 3. In order to ensure fulfilment of the requirements pursuant to Article 124 para. 1 VAG 2016, insurance and reinsurance undertakings must create and implement written internal company policies related to ALM and investments in accordance with Article 110 para. 1, 2 nos. 2 and 3 and para. 6 in conjunction with Article 107 para. 3 VAG 2016, which include at least the following components, provided that these are relevant to the investments of the undertaking:

1. segmentation of the whole portfolio at least at the balance sheet group level in accordance with Article 140 para. 1 VAG 2016;
2. investment objectives with due regard to obligations under insurance contracts and other liabilities, risk, return, time horizon and liquidity requirements;
3. processes for ALM;
4. criteria for the security, quality, liquidity, profitability and availability of the whole portfolio and the limit system derived from this;
5. strategic asset allocation, suitable deviation parameters and rules for determining these;

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6. definition of the investment universe in accordance with asset categories;
7. investment processes related to the asset categories under no. 6;
8. specification of the escalation mechanisms in the event that the limits set out in accordance with no. 4 and Article 6 are exceeded;
9. scope and frequency of internal credit risk assessments pursuant to Article 8, including the determination of criteria whereby a new credit risk assessment is required;
10. conditions under which the insurance or reinsurance undertaking is able to engage in securities lending and repurchase agreements;
11. processes for assessing the valuation of assets and monitoring developments in their value.

Organisational separation

Article 4. In order to ensure fulfilment of the requirements pursuant to Article 124 para. 1 nos. 1 to 4 VAG 2016, the valuation of the assets, the processing and recording of the transactions in accounting must be separated from the asset selection as part of the investment from an organisational point of view in accordance with Article 107 para. 2 no. 1 VAG 2016.

Documentation

Article 5. The basic principles for investment decisions along with the ongoing monitoring of the changes in value and of the credit risk must be documented appropriately in order to be able to identify, measure, monitor, manage and control the risks of the investment appropriately in accordance with Article 124 para. 1 no. 1 VAG 2016 and to be able to report on these appropriately. All transactions must be recorded promptly and in full.

Mix and diversification

Article 6. (1) For the purposes of ensuring appropriate mix and diversification in accordance with Article 124 para. 1 no 7 VAG 2016, insurance and reinsurance undertakings must determine and implement a suitable limit system with quantitative investment limits for all relevant concentration risks, and in any case for the asset categories defined pursuant to Article 3 no. 6, for issuers or counterparties including those that belong to the same group of companies in accordance with Article 74 para. 7 of the Investment Fund Act (InvFG; *Investmentfondsgesetz*) 2011, Federal Law Gazette I No. 77/2011, in the version of the Federal Act in Federal Law Gazette I No. 117/2015, and for geographical regions.

(2) The following applies to the monitoring of quantitative investment limits pursuant to para. 1 in relation to investments in undertakings for collective investment in transferable securities (UCITS) pursuant to Article 2 InvFG 2011, Federal Law Gazette I No. 77/2011, in the version of the Federal Act in Federal Law Gazette I No. 117/2015, in shares in alternative investment funds (AIFs) pursuant to Article 2 para. 1 no. 1 of the AIF Manager Act (AIFMG), Federal Law Gazette I No. 135/2013, in the version of the Federal Act in Federal Law Gazette I No. 117/2015, in other investments in the form of funds as well as in indirect risk exposure pursuant to Art. 84 para. 2 of the Delegated Regulation (EU) 2015/35:

1. If the insurance or reinsurance undertaking has a significant influence on the management or investment of the assets invested pursuant to the first sentence, then insurance and reinsurance companies must look through to the individual assets underlying the investments stated in the first sentence (look-through approach).
2. If there is no significant influence, then the look-through approach must take place based at least on a target allocation pursuant to Art. 84 para. 3 of the Delegated Regulation (EU) 2015/35 to the individual asset categories of the underlying investments stated in the first sentence.

(3) A significant influence by the insurance and reinsurance undertaking on the management or investment of the assets stated in the first sentence of Article 6 para. 2 is assumed if

1. the investments pursuant to the first sentence of para. 2 are managed by undertakings affiliated with the insurance or reinsurance undertaking, or

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2. the insurance or reinsurance undertaking holds more than 50% of the assets of the investment pursuant to the first sentence of para. 2, or
3. the insurance or reinsurance undertaking is otherwise able to influence the investment policy or investment decisions of the company managing the assets. The ability to influence the investment policy or investment decisions must be assumed in any case if investment of the corresponding assets is outsourced by the insurance or reinsurance company in a manner that is considered significant or critical for the purposes of Article 109 para. 2 VAG 2016.

(4) The assumption pursuant to para. 3 shall not apply if the insurance or reinsurance undertaking is able to show that there is no significant influence despite fulfilment of the conditions stated in para. 3.

(5) With fund of funds the look-through approach must be repeated an adequate number of times as part of the monitoring of the quantitative investment limits pursuant to paras. 2 and 3.

(6) By way of derogation from paras. 2 and 3, for assets in UCITS whose investment strategy is based on replicating the performance of one or more indices (index-replicating UCITS), the look-through approach may only take place based on a target allocation pursuant to Art. 84 para. 3 of Delegated Regulation (EU) 2015/35.

(7) Paras. 1 to 4 do not apply to assets that are held for unit-linked or index-linked life insurance pursuant to Article 125 VAG 2016. The provisions under paras. 1 to 4 must be applied to meet the cover requirements of the state-aided pension provision pursuant to Article 300 para. 1 no. 6 VAG 2016, with due consideration of the special features of the state-aided pension provision pursuant to Articles 108g to 108i of the Income Tax Act 1988 (EStG 1988; *Einkommensteuergesetz*), Federal Law Gazette No. 400/1988, in the version of the Federal Act in Federal Law Gazette I No. 118/2015.

Key risk indicators

Article 7. In order to ensure that insurance and reinsurance undertakings only invest in assets for which it is able to identify, measure, monitor, manage and control the risks appropriately and whose risks it is able to report appropriately in accordance with Article 124 para. 1 no. 1 in conjunction with Article 110 para. 2 no. 3 VAG 2016, insurance and reinsurance undertakings must develop their own risk indicators which must be implemented within the scope of the investment and must include all essential risk indicators, including at least the following elements:

1. comparison of the interest rate sensitivity of assets and liabilities;
2. deviations from the strategic and/or tactical asset allocation
3. deviations from the limit system for all other relevant concentration risks in accordance with Article 3 no. 4 and Article 6 para. 1;
4. proportion of unlisted assets and assets that are not regularly traded;
5. structure of the segments in accordance with Article 3 no. 1 as regards to credit quality, term structure or interest rate sensitivity, currency and geographical region;
6. market value of the equivalent position in the asset underlying the derivative in accordance with Article 4 para. 1 in conjunction with Annex 1 Section A of the 4th Austrian Regulation on Risk Measurement and Reporting of Derivatives, Federal Law Gazette II No. 266/2011 in the version of the Regulation in Federal Law Gazette II No. 267/2015, when using derivatives to facilitate efficient portfolio management in accordance with Article 124 para. 1 no. 5 Insurance Supervision Act 2016, along with key sensitivity indicators for derivatives with material exposure and
7. proportion of the whole portfolio of assets pursuant to the first sentence of Article 6 para. 2, to which the look-through approach is not applied to individual assets pursuant to Article 6 para. 2 no. 1.



Credit risk assessment

Article 8. In order to ensure that insurance and reinsurance undertakings invest all assets in a manner that guarantees the security, quality, liquidity and profitability of the entire portfolio in accordance with Article 124 para. 1 no. 2 VAG 2016, insurance and reinsurance undertakings must observe the following when evaluating the credit quality of the issuers and/or counterparties:

1. A suitable separate credit risk assessment must be carried out in any case for more complex or material investments or investment activities with a credit risk, as well as for loans. With respect to the determination of material investments or investment activities, exposure must be counted together when this is in relation to the same issuer or different issuers in the same group of undertakings in accordance with Article 74 para. 7 InvFG 2011, or in relation to the same counterparty or different counterparties in the same group of companies in accordance with Article 74 para. 7 InvFG 2011.
2. The credit risk assessment in accordance with no. 1 must be carried out both at the level of the individual issuer and/or the individual counterparty and at group level if the issuer and/or counterparty belongs to the same group of undertakings in accordance with Article 74 para. 7 InvFG 2011. Measures that improve the credit quality such as guarantees or collateral must be taken into account with this.
3. If relevant, the credit risk assessment in accordance with no. 1 must include an analysis of macroeconomic developments, key balance sheet and market figures, reports from external rating agencies, the contract documentation and the ongoing monitoring of news which could be an indication of a change in the credit risk.
4. The information used for the credit risk assessment in accordance with no. 1 must be procured from reliable sources and must take account of an adequate number of data points with respect to the scope and up-to-date nature in order to enable a holistic consideration of the credit risk over multiple periods of time.

Liquidity

Article 9. In order to ensure that all obligations assumed from securities and derivative transactions can be fulfilled in full upon maturity, insurance and reinsurance undertakings must ensure that the composition of the whole portfolio ensures that an appropriate amount of liquid funds is available on a continuous basis in accordance with Article 124 para. 1 nos. 2 and 3 VAG 2016.

Securities lending transactions and repurchase agreements

Article 10. (1) In order to ensure the security, quality and liquidity of the whole portfolio in accordance with Article 124 para. 1 no. 2 VAG 2016, collateral that can be considered to be highly liquid in nature, such as cash at bank, gold, government, corporate or covered bonds with at least a high credit quality in accordance with Art. 46 para. 3(a) of Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories, OJ No. L 201 from 27/07/2012 p. 1, last amended by Directive (EU) 2015/1515, OJ No. L 239 from 15/09/2015 p. 63, must be provided for securities that are the subject of securities lending and repurchase agreements. (2) The fair value of the collateral provided may not at any time fall below the fair value of the securities lent and the collateral must be deposited in securities accounts or accounts that the securities borrower cannot access in the event of bankruptcy or insolvency. Securities lending transactions and repurchase agreements are only permitted at prudent levels and exclusively in the best interests of all policyholders and those entitled to benefits.

(3) Paras. 1 and 2 apply to securities lending and repurchase agreements held directly and analogously within assets for which there is a significant influence with regard to their management or investment pursuant to Article 6 para. 3. In terms of the state-sponsored retirement provision pursuant to Article 300 para. 1 no. 6 VAG 2016, the prudent level pursuant to para. 2 must be assessed with due regard to the special features of the state-sponsored retirement provision in accordance with Articles 108g to 108i EStG 1988.



Derivative instruments

Article 11. (1) When using derivative instruments, the permissible usage purpose must be evidenced pursuant to Article 124 para. 1 no. 5 VAG 2016 with due regard to the following requirements:

1. With usage for the purpose of reducing risks, insurance and reinsurance undertakings must be capable at all times of providing quantitative evidence of the risk-reducing effect for the entire period of the planned usage. Insurance and reinsurance undertakings must equally be capable of providing evidence at all times that no additional substantial risks arise through the use of derivative instruments.
2. In the event of usage in order to facilitate efficient portfolio management, insurance and reinsurance undertakings must be capable at all times of providing quantitative evidence that the risk profile produced does not deviate substantially from a risk profile for which no derivative instruments are used, and that no additional essential risks arise through the use of derivative financial instruments.

(2) In order to ensure the security, quality, liquidity and profitability of the entire portfolio pursuant to Article 124 para. 1 no. 2 VAG 2016, speculative investments with high leverage, short holding periods or high transaction frequency, or within the scope of arbitrage strategies as well as the use of short put options are only permitted at prudent levels.

(3) Assets as well as liabilities considered individually as well as in their entirety for each segment pursuant to Article 3 no. 1 are deemed to be risk exposure to be hedged pursuant to Article 124 para. 1 no. 5 VAG 2016.

(4) The indicators pursuant to Article 7 no. 6 as well as the operational, liquidity and counterparty default risks must be taken into account at a minimum for risk management related to derivative instruments.

(5) Paras. 1 to 4 apply to investments held directly and investments pursuant to the first sentence of Article 6 para. 2 for which the insurance or reinsurance undertaking has a significant influence pursuant to Article 6 para. 3.

Section 2

Special provisions for the *Deckungsstock*

General provisions

Article 12. (1) In order to ensure that assets to cover the technical provisions are invested in the best interest of all policyholders and those entitled to benefits in accordance with Article 124 para. 1 no. 3 VAG 2016, only the following assets may be held to meet the cover requirement in accordance with Article 301 VAG 2016:

1. investments pursuant to Article 144 para. 2 items B.I., B.II. and B.III.1 to B.III.7 VAG 2016; other loans pursuant to Article 144 para. 2 item B.III.6 VAG 2016, however, only to the extent that these are loans that can be utilised once pursuant to Article 13 no. 3;
2. proportional interest and rents pursuant to Article 144 para. 2 item E VAG 2016, only to the extent that this involves proportional interest;
3. cash at bank in current accounts, cheques and cash in hand pursuant to Article 144 para. 2 item F.II VAG 2016, only to the extent that this involves current cash at bank and cash in hand;

(2) Without prejudice to para. 1, the following assets may not under any circumstances be held to meet the cover requirement pursuant to Article 301 Insurance Supervision Act 2016:

1. assets that are used for securities coverage pursuant to Article 14 para. 5 and para. 7 EStG 1988;
2. securities issued by the undertaking itself;
3. shares in undertakings to which critical or important operational functions or activities have been outsourced in accordance with Article 109 VAG 2016;

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4. shares in undertakings for whose obligations the insurance undertaking is liable as a personally liable partner or whose profits and losses are assumed by the insurance undertaking within the scope of profit and loss transfer agreements.

(3) The provisions under Articles 16 and 17 apply to unit-linked or index-linked life insurance by way of derogation from para. 1 and Article 13.

Special provisions for individual assets

Article 13. The following basic principles must be observed in order to ensure that assets that are held to meet the cover requirement pursuant to Article 301 VAG 2016 are invested in the best interest of all policyholders and those entitled to benefits pursuant to Article 124 para. 1 nos. 3 and 4 VAG 2016:

1. Unless any debt securities held to meet the cover requirement pursuant to Article 301 VAG 2016 are merely negligible in scope, the majority of these debt securities must at a minimum have a high credit quality for the purposes of the credit risk assessment pursuant to Article 8.
2. Shares in an AIF may only be held to meet the cover requirement pursuant to Article 301 VAG 2016 at a prudent level; this restriction does not apply to
 - a) special funds pursuant to Article 163 InvFG 2011 or those managed by an asset management company domiciled in another Member State and which feature the characteristics in accordance with Article 163 InvFG, and
 - b) real estate funds pursuant to Article 1 of the Real Estate Investment Fund Act, Federal Law Gazette I No. 80/2003, in the version of the Federal Act in Federal Law Gazette I No. 115/2015, and real estate funds that are similar to these that are managed by an asset management company domiciled in another Member State and which are subject to public supervision.
3. Loans may only be held to meet the cover requirement pursuant to Article 301 VAG 2016 at a prudent level, and only if they can only be utilised once and are not subordinated. They must also at a minimum be of a high credit quality for the purposes of the credit risk assessment pursuant to Article 8 or have adequate collateral. In the case of mortgage loans, the property must be located in Austria or in another Member State and be adequately insured against natural hazards and the market value of the property may be mortgaged at up to 60%.
4. Derivative instruments pursuant to Article 11 para. 1 no. 2 may only be held to meet the cover requirement pursuant to Article 301 VAG 2016 at a prudent level. Derivative instruments pursuant to Article 11 para. 1 no. 1 must relate to risk exposure in the same *Deckungsstock* group pursuant to Article 300 VAG 2016.
5. Structured debt securities may only be held to meet the cover requirement pursuant to Article 301 VAG 2016 at a prudent level.

Repayment, redemptions and interest

Article 14. (1) Assets pursuant to Article 12 para. 1 may only be held to meet the cover requirement pursuant to Article 301 VAG 2016 if it can be guaranteed that repayments and redemptions are received into a bank account which is held separately by *Deckungsstock* group pursuant to Article 302 para. 3 VAG 2016 and that is entered into a *Deckungsstock* list pursuant to Article 249 VAG 2016 and that belongs to the same *Deckungsstock* group as the *Deckungsstock* asset.

(2) Proportional interest of assets that are held to meet the cover requirement pursuant to Article 301 VAG 2016 may be used to meet the cover requirement in the same *Deckungsstock* group pursuant to Article 300 para. 1 nos. 1 to 8 VAG 2016 provided that the interest is credited to a bank account from the same group.

Availability

Article 15. (1) Loans pursuant to Article 13 no. 3, receivables such as proportional interest and cash at bank may only be held to meet the cover requirement pursuant to Article 301 VAG 2016 at a prudent level. All English translations of the authentic German text is unofficial and serves merely information purposes. The official wording in German can be found in the Austrian Federal Law Gazette (Bundesgesetzblatt; BGBl.). All translations have been prepared with great care, but linguistic compromises had to be made. The reader should also bear in mind that some provisions of these laws will remain unclear without certain background knowledge of the Austrian legal and political system. Please note that these laws may be amended in the future and check occasionally for updates.



VAG 2016 if the debtor, with management in trust the trustees, and the guarantor have waived any right of offset or retention in writing. Securities may only be held to meet the cover requirement pursuant to Article 301 VAG 2016 if the custodian has waived any right of offset or retention in writing.

(2) In order to ensure availability pursuant to Article 124 para. 1 no. 2 VAG 2016, bearer securities that are held to meet the cover requirement pursuant to Article 301 VAG 2016 must be deposited with a bank or financial institution which is authorised to operate a depository business as a custodian, whereby it must be ensured that the relevant securities deposited represent a special fund with the custodian which does not form part of the assets in the event of bankruptcy or insolvency proceedings. The liability of the custodian or the interim custodian for the culpability of third-party custodians cannot be limited or excluded by contract.

(3) Bearer securities as well as other assets to be stored must be held in sufficiently safe custody.

Unit-linked life insurance

Article 16. (1) In order to ensure that, pursuant to Article 125 para. 1 in conjunction with Article 124 para. 1 nos. 1 to 4 VAG 2016, the assets to cover the technical provisions for unit-linked life insurance comply with the prudent person principle and in particular are invested in the best interest of all policyholders and those entitled to benefits, insurance undertakings must apply due diligence when selecting investment funds and their managers. The organisation of the manager and their service providers, the documentation related to the fund and its income and risk profile must be taken into account with this in particular.

(2) Apart from the relevant shares in investment funds pursuant to Article 125 para. 2 VAG 2016, cash at bank may only be held to meet the cover requirement pursuant to Article 301 VAG 2016 in conjunction with Article 300 para. 1 no. 3 VAG 2016 in unit-linked life insurance to a negligible extent pursuant to Article 15 para. 1 for the purposes of temporary investment and advance payments on policies in accordance with Article 302 para. 2 VAG 2016.

(3) If a benefit involves a right to choose between shares in investment funds or monetary benefits, the investment funds available to the policyholder for selection must be registered for public sale in the relevant Member State in which insurance contracts are offered.

Index-linked life insurance

Article 17. In order to ensure that, pursuant to Article 125 para. 1 in conjunction with Article 124 para. 1 nos. 1 to 4 VAG 2016, the assets to cover the technical provisions for index-linked life insurance comply with the prudent person principle and, in particular, are invested in the best interest of all policyholders and those entitled to benefits, insurance undertakings must ensure in particular that

1. the assets to cover the technical provisions as well as the issuers of these assets feature at a minimum a high credit quality at the time of the acquisition for the purposes of the credit risk assessment under Article 8, provided that there is a credit risk;
2. the assets to cover the technical provisions and the values upon which the reference value is based are valued in the form of precise, reliable and established prices, which are either market prices or are based on a valuation system independent of the issuer and are comprehensible externally;
3. the assets to cover the technical provisions feature appropriate risk diversification;
4. the guarantor features at a minimum a high credit quality for the purposes of the credit risk assessment pursuant to Article 8 in the event of an external capital guarantee;
5. the allocation of assets to insurance products and groups of insurance contracts has a clear and comprehensible structure and is adequately documented.



Section 3

Transitional and final provisions

Article 18. (1) The regulation shall enter into force on 1 January 2016.

(2) By way of derogation from Articles 12, 16 and 17, the assets dedicated to the *Deckungsstock* as at 31 December 2015 in accordance with the provisions of the Investment Regulation, Federal Law Gazette II No. 2002/383 in the version of the Regulation in Federal Law Gazette II No. 409/2013, may also remain dedicated to the *Deckungsstock* after 31 December 2015.