Background to the Insurance Distribution Directive

Last year the EU updated the regulatory framework for the sale of insurance by introducing the Insurance Distribution Directive (2016/97/EU) (**IDD**). This will repeal and replace the Insurance Mediation Directive (2002/92/EC) (**IMD**). The IMD covers the activities of insurance agents and brokers selling insurance and reinsurance products, but does not cover direct sales by insurers and reinsurers. The IMD was a minimum harmonising directive setting a minimum standard; member states had the flexibility to introduce additional provisions in order to protect consumers. The IDD seeks to further harmonise how insurance distribution activities are regulated across the single market to improve consumer protection standards and promote a single market for insurance sales.

The IDD is also a minimum harmonising directive and will be transposed in the UK through the Financial Services and Markets Act 2000 (**FSMA**) in the same way as the IMD. This will involve a combination of new legislation and FCA rules. The FCA has published the first of two consultation papers setting out its proposals for implementing the IDD.

This briefing considers the key provisions of the IDD and the impact of its implementation in the UK.

Summary of amendments to existing IMD rules

- The IDD extends the scope of the IMD to all sellers of insurance products, including insurers and reinsurers that sell directly to customers.
- Providers of insurance products on an ancillary basis (for example some travel agents and car rental companies) also come within the scope of the IDD.
- After-sales services are covered by the IDD.
- The IDD introduces requirements relating to the knowledge and ability of those selling insurance products and to the continuing professional development of employees of firms who distribute insurance products.
- The IDD provides more detail on the passporting procedure for intermediaries distributing insurance products across the EU.
- The IDD includes enhanced conflicts of interest requirements and amends the IMD information and conduct of business requirements. This is consistent with the MiFID II Directive.
- The IDD includes a specific product governance regime for manufacturers of insurance products, which can include intermediaries as well as insurers.
- The IDD introduces additional conduct of business standards for firms involved in the distribution of insurance-based investment products (**IBIPs**), which are identified as high-risk products.
**Application of the IDD**

The IDD introduces a number of new defined terms including 'insurance distribution' and 'insurance distributor' and by doing so, the IDD extends the scope of the IMD to cover all participants involved in the sale of insurance and reinsurance products in the EU. The IDD applies to anyone who takes up or pursues the distribution of insurance or reinsurance products, including agents, brokers, 'bancassurance' operators, insurers and reinsurers. The IDD applies to direct insurers and reinsurers that distribute their own products to consumers without the involvement of an intermediary. In the UK, however, this is not a significant change as the original IMD provisions were ‘gold-plated’ in the UK to include direct insurers and reinsurers who sold products directly to customers.

The IDD also covers providers of after-sales services and it applies to firms that distribute insurance products on an ancillary basis, so-called ‘ancillary insurance intermediaries’ eg some travel agents and car rental companies, unless they fall within one of the exemptions set out below. This concept of ‘ancillary insurance intermediaries’ is new under the IDD and is designed to capture those persons whose main business is not insurance-related business, but who carry on insurance or reinsurance distribution as a secondary activity. An ‘ancillary insurance intermediary’ is defined in the IDD as a person (other than a credit institution or an investment firm as defined in the Capital Requirements Regulation No 575/2013 (CRR)), who takes up or pursues the activity of insurance distribution for remuneration on an ancillary basis, provided that all of the following conditions are met:

a) the principal professional activity of that person is something other than insurance distribution;

b) that person only distributes certain insurance products that are complementary to a good or service; and

c) the insurance products concerned do not cover life assurance or liability risks, unless that cover complements the good or service which the intermediary provides as its principal professional activity.

The IDD makes it clear that consumers should benefit from the same level of protection despite the differences between distribution channels. Accordingly, in order to guarantee that the same level of protection applies and that the consumer can benefit from comparable standards (in particular in the area of the disclosure of information), the IDD seeks to create a level playing field between distributors.

The IDD covers all insurance products including general insurance policies and life insurance policies. Where a life policy contains an investment element, known as an IBIP, it will be subject to more stringent rules under the IDD.
### ‘Insurance distribution’ and ‘reinsurance distribution’ under the IDD

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<tr>
<th>Activity</th>
<th>Definition under IDD</th>
<th>UK impact</th>
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<tr>
<td>Insurance distribution</td>
<td>• Advising on contracts of insurance.</td>
<td>• The adoption of the IMD in the UK in 2005 was ‘super-equivalent’ and ‘advising on contracts of insurance’ was included as a regulated activity. The inclusion of this activity in the IDD will not have a significant impact in the UK.</td>
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<td>• Concluding contracts of insurance.</td>
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<td>• Assisting in the administration and performance of contracts of insurance, in particular in the event of a claim.</td>
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<td>• The provision of information concerning one or more insurance contracts in accordance with criteria selected by customers through a website or other media and the compilation of an insurance product ranking list, including price and product comparison, or a discount on the price of an insurance contract, when the customer is able to directly or indirectly conclude an insurance contract using a website or other media.</td>
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When are insurance-related activities not covered by the IDD?

Certain insurance-related activities are outside the scope of the IDD including where information is provided to customers on an 'incidental basis' in the context of another professional activity. Recital 14 of the IDD excludes tax experts, accountants and lawyers etc who provide advice on an incidental basis from the scope of the IDD. Managing an insurance or reinsurance undertaking’s claims on a professional basis, as well as loss adjusting and expert appraisal of claims is outside of the scope of the IDD. The provision of data and information on potential policyholders to insurance or reinsurance intermediaries is also excluded from the scope of the IDD. Merely providing information about insurance or reinsurance products, by an insurance or reinsurance intermediary or an insurance or reinsurance undertaking to potential policyholders is also outside the scope of the IDD. However, all of these activities are only excluded if the provider does not take any additional steps to assist in the conclusion of a contract of insurance or reinsurance.

Where the insurance or reinsurance distribution activities relate to risks and commitments outside the EU or those activities are carried out in third countries, these are also outside the scope of the IDD.

‘Connected contracts’ exemption

In addition to insurance activities that are not covered by the IDD, there is one exemption from the scope of the IDD that applies to certain ancillary insurance intermediaries. The IDD does not apply to ancillary insurance intermediaries that carry out insurance distribution activities where all the following conditions are met:

a) the insurance is complementary to the good or service supplied by a provider, where that insurance covers:
   i. the risk of breakdown, loss of, or damage to, the good or the non-use of the service supplied by that provider; or
   ii. damage to, or loss of, baggage and other risks linked to travel booked with that provider;

b) the amount of the premium paid for the insurance product does not exceed €600 calculated on a pro rata annual basis; and

c) by way of derogation from point (b) above, where the insurance is complementary to a service referred to in point (a) and the duration of that service is equal to, or less than, three months, the amount of the premium paid per person does not exceed €200.

However, where an insurance undertaking or insurance intermediary carries out distribution through an exempted ancillary insurance intermediary, the insurance undertaking or insurance intermediary is under an obligation to ensure that certain IDD requirements remain fulfilled including the requirement to provide an insurance product information document (IPID) to the customer before the contract is concluded (discussed further below).

This directive is a significant piece of legislation with implications for the insurance industry as a whole. Many of the changes extend UK standards to other parts of the EU and where domestic provisions already exist we will seek to minimise the disruption to UK firms.

Christopher Woolard
Executive Director of Strategy and Competition at the FCA
### Overview of key provisions of the IDD

<table>
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<th>Subject</th>
<th>Summary of provision(s)</th>
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| **Registration** | • Insurance, reinsurance and ancillary insurance intermediaries must be registered in their home member state.  
• By contrast, insurance and reinsurance undertakings (and their employees) are not required to register.  
• Where a distributor is responsible for the activities of an intermediary (for example an appointed representative), it is the distributor’s responsibility to ensure that the intermediary satisfies the registration conditions.  
• The IDD goes further than the IMD in respect of the information that has to be provided for registration. This includes: the identities of shareholders or members that have a holding in the intermediary that exceeds 10 per cent, together with the amounts of those holdings; and the identities of persons that have close links with the intermediary. |
| **Freedom to provide services** | • Intermediaries conducting business in another member state for the first time must communicate certain information to the competent authority of their home Member state before commencing business in the host territory, to be communicated to the host member state.  
• If the intermediary acting under the freedom to provide services is in breach of any obligation under the IDD, the competent authorities must take measures to remedy the situation.  
• The intermediary may be prevented from carrying on new business within the relevant host territory. |
| **Freedom of establishment** | • Intermediaries conducting business in another member state for the first time must communicate certain information to the competent authority of their home member state before establishing a branch or permanent presence in the host territory, to be communicated to the host member state.  
• If the intermediary acting under the freedom of establishment is in breach of any obligation under the IDD or of the legal or regulatory provisions adopted in the host territory, the competent authorities must take measures to remedy the situation, including that the intermediary may be prevented from carrying on new business within the relevant host territory. |
| **‘General good’ rules** | • Each member state has legal provisions for protecting the general good. These may go beyond those in the IDD as long as they are proportionate. |
| **Professional and organisational requirements** | • Distributors and employees of undertakings conducting distribution activities must possess appropriate knowledge and ability, and comply with continuing professional development requirements (at least 15 hours a year). Individuals must be of good repute.  
• Intermediaries require professional indemnity insurance covering the whole of the EU for at least €1,250,000 for each claim or €1,850,000 per year for all claims. |
## Summary of provision(s)

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- Member states must set up procedures allowing customers to complain about distributors.  
- All complaints must receive replies. They must also ensure adequate out-of-court complaint and redress procedures for settling disputes. |
| **Conduct of business** |  
- New general principle on insurance distributors to always act honestly, fairly and professionally in accordance with the best interests of their customers. Remuneration policies for employees should not encourage conduct contrary to this principle. |
| **Information requirements** |  
- All information addressed to customers must be fair, clear and not misleading. It must be objective, comprehensible and allow the customer to make an informed decision, consistent with the customer’s demands and needs.  
- Important information must be disclosed in good time before the conclusion of an insurance contract in relation to: the identity of the intermediary or undertaking, its regulatory status and the advice it provides, the complaints procedure, any conflicts of interest, and detailed fee information.  
- The IDD sets out specific requirements for the medium, format, language, etc. Any marketing communications must be identifiable as such. |
| **Product oversight and governance** |  
- Where an undertaking or intermediary manufactures an insurance product, it must establish an appropriate and proportionate process for reviewing the approval of the product (and conducting a regular review of it) before marketing it to customers. Any information relating to approval must be provided to the distributor. |
| **Insurance-based investment products** |  
- Intermediaries or undertakings must establish proportionate arrangements to prevent conflicts of interest and clearly disclose conflicts to customers where they cannot be prevented.  
- Information must be provided in good time to the customer in relation to: the suitability of products, the risks of certain products or strategies, and costs and related charges.  
- They must obtain information on the customer’s knowledge and experience in the relevant investment field and financial situation in order to offer a suitable product. |
| **Sanctions and other measures** |  
- Administrative or criminal sanctions may be imposed for any infringement of the IDD (including on the members of management of distributors).  
- Administrative sanctions and other measures must be effective, proportionate and dissuasive.  
- The IDD sets out minimum sanctions for certain infringements including: requiring the offending conduct to be ceased; withdrawal of an intermediaries registration; ban on exercising management functions; and pecuniary sanctions. |
Registration requirements

Insurance, reinsurance and ancillary insurance intermediaries are required to be registered with a competent authority in their home member state. Where insurance, reinsurance or ancillary insurance intermediaries act under the responsibility of an insurance or reinsurance undertaking, or another intermediary, member states may provide that the insurance or reinsurance undertaking or other intermediary: is responsible for ensuring that the relevant insurance, reinsurance or ancillary insurance intermediary meets the registration conditions; and takes responsibility for registering the relevant insurance, reinsurance or ancillary insurance intermediary.

Insurance and reinsurance undertakings and their employees will be authorised under the Solvency II Directive (2009/138/EC) and accordingly do not need to be registered under the IDD. However, they remain subject to the requirements of the IDD.

Passporting under the IDD

Passporting rights for insurance intermediaries under the IMD were limited. The IDD provides more detailed passporting provisions, although these only apply to insurance intermediaries. The passporting provisions for insurance and reinsurance undertakings are set out in the Solvency II Directive.

For firms operating cross-border, whether EEA firms engaging in insurance distribution activities in the UK; or UK firms engaging in insurance distribution activities elsewhere in the EEA, the IDD simplifies the procedure for cross-border entry and makes changes to the passporting notification processes.

The IDD will be affected by the UK’s withdrawal from the EU however there is little clarity yet on how. The UK government will have to consider which parts of the IDD, if any, it wants to repeal following the withdrawal from the EU particularly if there are parts of the IDD that go beyond what the UK government would choose to implement in the UK. However, for now at least, the Treasury proposals confirm that the IDD will be transposed into UK law in its entirety.

Exercise of the freedom to provide services

Any insurance, reinsurance or ancillary insurance intermediary who intends to carry on business within the territory of another member state for the first time under the freedom to provide services must communicate certain information to the national competent authority (NCA) of its home member state:

a) the name, address and, where applicable, the registration number of the intermediary;
b) the member state or member states in which the intermediary intends to operate;
c) the category of intermediary and, where applicable, the name of any insurance or reinsurance undertaking represented; and
d) the relevant classes of insurance, if applicable.

Within one month of receiving this information, the NCA of the home member state must communicate it to the NCA of the host member state. Article 4(2) of the IDD sets out detailed provisions relating to the exchange of information and notification requirements that will allow the intermediary to commence business in the host member state.

Where an intermediary carries on business by exercise of the freedom to provide services, the NCA of the home member state is responsible for ensuring that the intermediary complies with the IDD with regard to the entire business in the internal market. However where the NCA of the host member state has reason to consider that an intermediary acting within its territory under the freedom to provide services is in breach of any obligation under the IDD, it must communicate those considerations to the NCA of the home member state. If the situation is not remedied, the host member state has the power to take ‘appropriate measures to remedy the situation; these measure include preventing the intermediary from carrying on business within the host member state’s territory.
**Exercise of the freedom of establishment**

Any insurance, reinsurance or ancillary insurance intermediary that intends to exercise the freedom to establish a branch\(^1\) or permanent presence within the territory of another member state must provide the following information to the NCA of its home member state:

a) the name, address and, where applicable, the registration number of the intermediary;

b) the member state within the territory of which the intermediary plans to establish a branch or permanent presence;

c) the category of intermediary and, if applicable, the name of any insurance or reinsurance undertaking represented;

d) the relevant classes of insurance, if applicable;

e) the address in the host member state from which documents may be obtained; and

f) the name of any person responsible for the management of the branch or permanent presence.

Within one month of receiving this information, the NCA of the home member state must communicate it to the NCA of the host member state. Article 6(2) of the IDD sets out detailed provisions relating to the exchange of information and notification requirements that will allow the intermediary to commence business in the host member state.

If the intermediary’s place of business is located in a different member state to the home member state, the NCA of that other member state may agree to act as if it were the home member state NCA in relation to certain provisions of the IDD.

Where a branch is established or an intermediary has a permanent presence in another member state, the IDD provides for the division of responsibility for enforcement between the home and host member states.

**Organisational requirements**

**Knowledge and ability**

The IDD requires insurance distributors and their employees to have appropriate knowledge and ability; demonstrated by completing a minimum of 15 hours per year of continuing professional development (**CPD**). The IDD sets out criteria for minimum knowledge, which include areas such as product and market knowledge.

In the UK, firms are currently required by the FCA’s Senior Management Arrangements, Systems and Controls sourcebook (SYSC) to ensure their employees have the knowledge, skills and expertise necessary to carry out their responsibilities. The FCA expect firms to undertake ongoing training and firms subject to the FCA Training and Competence Sourcebook (TC) must complete 35 hours of CPD.

Under the IDD, member states must ensure that the level and knowledge and ability matches the level of complexity of the particular insurance or reinsurance distribution activity carried on and the particular products that are distributed. The current FCA rules and guidance state that when complying with the ‘competent employees’ rules, a firm must take into account the nature, scale and complexity of its business and the nature and range of financial services and activities undertaken in the course of that business. In the UK, at least, the knowledge and ability requirements of the IDD are consistent with the existing rules. The FCA is, however, proposing to gold-plate the minimum knowledge criteria. The IDD minimum knowledge criteria only apply to insurance and reinsurance intermediaries. However, the FCA is proposing to also apply them to insurance and reinsurance undertakings as well as to intermediaries. The minimum knowledge criteria cover areas such as product coverage, the claims process and insurance regulation. The rationale behind applying these areas more broadly is because the FCA considers that these are areas which are just as relevant to insurers distributing products directly to the customer as they are to intermediaries. In the FCA’s view, these are areas on which it would expect insurers to train their employees.

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\(^1\) Under Article 2(1)(12) of the IDD, a ‘branch’ is defined as an agency or a branch of an intermediary which is located in the territory of a member state other than the home member state.
The knowledge and competence requirements will only apply to those employees directly involved in insurance distribution. This includes relevant people within the management structure with responsibility for insurance distribution (for example, product or sales managers). The requirements will not apply to employees in ancillary roles such as HR, facilities management and IT.

Record-keeping

The IDD also requires insurance and reinsurance undertakings to establish, maintain and keep appropriate records to demonstrate their compliance with the employee knowledge and ability requirements. The IDD does not prescribe time limits for record-keeping, however in the UK, the FCA proposes a minimum requirement that records should be held for not less than three years. This is in line with the requirements for firms subject to TC.

Professional indemnity insurance

Intermediaries must hold PII or a comparable guarantee against liability arising from professional negligence. Minimum levels of cover are €1,250,000 per claim per year, and €1,850,000 per year in aggregate. In the UK, existing rules are more detailed than the IDD requirements in some respects:

- a requirement for intermediaries to maintain a higher minimum aggregate cover – 10 per cent of annual income up to £30m – where this is greater than the IDD minimum amount;
- requirements around excess levels; and
- the need to have specific terms which the PII cover must incorporate (such as cover for legal defence costs and Ombudsman awards).

Client monies

Member states must take all necessary measures to protect customers against the inability of an insurance, reinsurance or ancillary insurance intermediary to transfer the premiums to the insurance undertaking or to transfer the premium to the insurance undertaking or to transfer the amount of claim or return premium to the insured. The IDD prescribes the form that these measures must take which includes:

- provisions laid down by law or contract whereby monies paid by the customer to the intermediary are treated as having been paid to the undertaking, whereas monies paid by the undertaking to the intermediary are not treated as having been paid to the customer until the customer actually receives them;
- a requirement for the intermediary to have financial capacity amounting, on a permanent basis, to 4 per cent of the sum of annual premiums received, subject to a minimum of €18,750;
- a requirement that customers’ monies be transferred via strictly segregated customer accounts and that those accounts not be used to reimburse other creditors in the event of bankruptcy; and
- a requirement that a guarantee fund be set up.

The IDD requirements relating to client assets are very similar to those in the IMD however the minimum intermediary financial capacity amount has increased and the provisions now apply to reinsurance intermediaries. The FCA has stated that it will consult formally on its CASS proposals in its second consultation paper later in the year, however it is considering amending CASS 5 so that it becomes compulsory in relation to reinsurance contracts (this is because reinsurance intermediaries are now covered by the IDD). CASS 5 is currently optional for reinsurance intermediaries.

Currently, intermediaries are given the option between risk transfer and segregation of accounts. The FCA is also considering narrowing the scope of available options for reinsurance mediation, for example, making CASS 5 compulsory but allowing only risk transfer. In addition, the FCA is considering whether to apply CASS 5.8, requiring safe keeping of client’s documents and other assets, to this business. The FCA is not yet consulting on these proposals and we will know more following publication of the second consultation.
Complaints handling and out-of-court redress

The IDD requires insurance and reinsurance distributors to have a process in place for customers and other eligible parties to register complaints and receive replies. This requirement applies to all types of insurance transaction, whether it involves a retail customer or a commercial customer, including reinsurance transactions.

The IDD also requires member states to have ‘adequate and effective, impartial and independent out-of-court complaint and redress procedures’ relating to customer complaints about insurance distribution activities which fall within the scope of the IDD.

In the UK, the FCA is proposing to implement these requirements of the IDD by relying on DISP, with amendments where necessary. It is proposed that DISP 1 will remain for eligible complainants and that a new rule will be created which will contain the existing requirement in DISP 1.1.8R and extend it to all insurance and reinsurance distributors when carrying on distribution activities. The FCA is also proposing to amend its rules to include complaints about insurance and reinsurance distribution business carried on by UK firms from a branch in another EEA state.
Conduct of business requirements

General principles
The IDD introduces general principles that apply to all insurance distributors. These are overarching requirements which are, in summary:

a) distributors must act honestly, fairly and professionally in the best interests of their customers;

b) distributors must communicate in a way which is clear, fair and not misleading, including ensuring that marketing materials are clearly identifiable as such; and

c) remuneration of a distributor or its employees, and performance management of employees, must not conflict with the duty to act in the customer’s best interests.

Amendments to the FCA Handbook
Whilst the rules are similar to the existing rules in ICOBS and SYSC, the FCA is proposing to make certain amendments to the Handbook to reflect the differences. The FCA is proposing to:

a) include a new rule in ICOBS requiring insurance distributors to act honestly, fairly and professionally in the best interests of their customers (‘the customer’s best interests rule’);

b) amend the current ICOBS rules on communications and financial promotions to require that all marketing communications be clearly identifiable as such; and

c) include a new rule in SYSC to prohibit remuneration and performance management practices that would conflict with the customer’s best interests rule.

These overarching general principles will apply to all firms carrying out insurance distribution activities, where they have a direct impact on the policyholder. This means that firms conducting insurance distribution activities as part of a distribution chain will be caught by the customer’s best interests rule. This will include, for example, a wholesale intermediary who concludes a policy placed with it by a retail intermediary, or a price comparison website that proposes a contract but directs a customer to another intermediary or insurer.

Pre-contract disclosures
In good time before the conclusion of an insurance contract, an insurance intermediary must disclose the following to customers:

1) its identity and address and that it is an insurance intermediary;

2) whether it provides advice about the insurance products sold;

3) the procedures enabling customers and other interested parties to register complaints about insurance intermediaries and about the out-of-court complaint and redress procedures;

4) the register in which it has been included and the means for verifying that it has been registered; and

5) whether the intermediary is representing the customer or is acting for and on behalf of the insurance undertaking.

In good time before the conclusion of an insurance contract, an insurance undertaking must disclose the following to customers:

1) its identity and address and that it is an insurance undertaking;

2) whether it provides advice about the insurance products sold; and

3) the procedures enabling customers and other interested parties to register complaints about insurance undertakings and about the out-of-court complaint and redress procedures.

* Under the IDD, ‘remuneration’ includes commission, fee, charge or other payment, including an economic benefit of any kind or any other financial advantage or incentive offered or given in respect of the insurance distribution activity.
In the UK, the IDD builds on the existing pre-contract information requirements currently in force. The key differences between the existing rules and the IDD are:

- the pre-contract disclosure regime now applies to insurance undertakings;
- firms must state what type of firm they are (an intermediary or an undertaking);
- firms must state whether they provide a personal recommendation; and
- insurance intermediaries must state whether they are acting on behalf of the customer or the insurance undertaking.

One of the FCA’s concerns is that customers do not always understand the difference between information and advice. Accordingly, the FCA believes that a well-worded and timely disclosure can help the customer understand the scope (and limitations) of the service the firm is providing. Therefore, the FCA is proposing to amend ICOBS to incorporate the new requirements.

### Conflicts of interest

The new requirements are aimed at helping customers to better understand the status of firms that sell insurance products with the ultimate aim of ensuring that conflicts do not adversely affect customers’ interests. The conflicts of interest provisions only apply to insurance intermediaries and require intermediaries to provide customers, in good time before the conclusion of an insurance contract, at least the following information:

- intermediaries must disclose if they have 10 per cent or more voting rights or capital in an insurer, or vice versa. Currently the requirement is ‘more than 10 per cent’;
- intermediaries must disclose if they give advice based on ‘a fair and personal’ analysis of the market;
- where an intermediary is contractually bound to place business with a specific insurer or insurers it must provide the names of those insurers. Currently this information need only be supplied on request by the customer; and
- where an intermediary is not contractually bound to place business with specific insurers but does not provide advice on the basis of a fair and personal analysis of the market, it must name the insurers with whom it may place business. Currently this information need only be supplied on request by the customer.

Issues around insurance broker remuneration and conflicts of interest have been debated for a number of years. The European Commission published a report in respect of its competition inquiry on the insurance sector in 2007, which concluded that broker remuneration would be addressed through revisions to the IMD. However, despite the original draft amendments to the IMD including broad remuneration disclosure requirements, the IDD only requires disclosure of the nature of the remuneration and the way in which this remuneration is calculated.

The IDD introduces new requirements for the pre-contract disclosure of information about an insurance distributor’s remuneration and whether the contract will work on the basis of a fee or commission or other type of arrangement. Insurers must also disclose the ‘nature’ of the remuneration paid to their employees. Where the remuneration is in the form of a fee paid by the customer, the amount of that fee must be disclosed. Firms are permitted to disclose the method of calculation instead of the actual amount, but only if the amount cannot be calculated at the time.

In the UK, under the current FCA rules, intermediaries must only disclose commission on demand to commercial customers; under the IDD this is extended to all retail customers.
Advised and non-advised sales standards

Demands and needs
To avoid the risk of mis-selling, the IDD requires that, prior to the conclusion of the insurance contract, an insurance distributor must specify (based on information obtained by the customer) the demands and needs of the customer. The distributor must then provide the customer with objective information about the insurance product in a 'comprehensible form' to allow the customer to make an informed decision.

Where advice is provided prior to the conclusion of any specific contract, the distributor must provide the customer with a personalised recommendation explaining why a particular product would best meet the customer’s demands and needs. This is in addition to the distributor specifying the customer’s demands and needs.

When an insurance intermediary informs a customer that it gives its advice on the basis of a fair and personal analysis, it must give that advice on the basis of an analysis of a sufficiently large number of insurance contracts available on the market which enable it to make a personal recommendation, in accordance with professional criteria, regarding which insurance contract would be adequate to meet the customer’s needs. The IDD provides that in order to determine whether the number of contracts and providers considered by an insurance intermediary is sufficiently large to constitute a fair and personal analysis, appropriate consideration should be given to the customer’s needs, the number of providers in the market, the market share of those providers, the number of relevant insurance products available from each provider; and the features of those products.

In the UK, the IDD builds on and amends the existing ICOBS standards for advised and non-advised sales. The IDD makes it clear that firms need to specify the customer’s insurance demands and needs based on information obtained by the firm from the customer. This makes it clear that firms have to take an active role in identifying the customer’s demands and needs.

In addition, the IDD requires that ‘any contract proposed shall be consistent with the customer’s insurance demands and needs’ meaning that firms must only offer contracts that meet the customers’ demands and needs. The FCA proposes to copy out this new provision into ICOBS 5. The FCA has identified two steps that firms will need to take to comply with the additional requirement, namely they must:

a) identify the customer’s demands and needs, and match them to the available products; and
b) state the customer’s demands and needs to assist them in making an informed decision.

Non-life insurance products
Where the product being distributed is a non-life insurance product, the IDD requires information to be provided to customers by way of a standardised product information document (PID or IPID). The IPID must be drawn up by the manufacturer of the product and should contain the following information:

a) information about the type of insurance;
b) a summary of the insurance cover, including the main risks insured, the insured sum and, where applicable, the geographical scope and a summary of the excluded risks;
c) the means of payment of premiums and the duration of payments;
d) main exclusions where claims cannot be made;
e) obligations at the start of the contract;
f) obligations during the term of the contract;
g) obligations in the event that a claim is made;
h) the term of the contract including the start and end dates of the contract; and
i) the means of terminating the contract.

EIOPA and the European Commission are currently considering the provisions of the IPID and accordingly the FCA will likely consult on the IPID in its second consultation paper due later this later.
**Cross-selling**

The IDD introduces new requirements for the cross-selling of insurance products. These requirements apply where an insurance policy is sold in connection with, or alongside, other goods or services as part of a package or the same agreement. The IDD requirements are similar to those in Article 24(11) of MiFID, however the requirements in the IDD go a step further. Under the IDD, different products cannot be bundled together which has caused concern in the industry.

Under the IDD, where insurance is the primary product, information must be given on whether the different components of the package can be bought separately. The distributor must also provide an adequate description of the component products, explain any interactions between the components, and provide separate information on the costs and charges (eg car insurance sold with the option to buy a telematics device). In packages where insurance is ancillary to other goods or service the customer must be able to buy the primary product or service without the insurance (eg insurance sold alongside mobile phones). In these packages the ancillary insurance must be optional. The IDD cross-selling provisions do not apply where insurance is sold ancillary to certain other financial products (such as payment accounts and mortgages) or ancillary to another insurance product.

The FCA is currently proposing to copy out the new IDD requirements into ICOBS 6.

**Product oversight and governance**

Product oversight and governance arrangements are another key feature of the IDD. Under the IDD, insurance intermediaries and insurance undertakings that manufacture insurance products must maintain, operate and review processes for the approval of each insurance product they offer, and review any significant adaptations of existing products before they are marketed or distributed to customers. The product approval process must be proportionate and appropriate to the nature of the insurance product.

The process requires firms to specify an identified target market for each product, ensure that all relevant risks to that target market are assessed and that the intended distribution strategy is consistent with the target market. Firms must take reasonable steps to ensure that the insurance product is distributed to the identified target market.

Firms are required to regularly review the insurance products they offer or market to assess whether the product remains consistent with the needs of the identified target market and whether the intended distribution strategy is still appropriate. In the UK, product governance and the requirements relating to the distribution of retail insurance products is not new. The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD) already goes some way to setting out the duties of insurance intermediaries, and the requirement on firms to act in the best interests of customers means that firms in the UK should already have in place robust product governance processes.

Under Article 25 of the IDD, the Commission can adopt delegated acts to set out the principles of product governance. In its technical advice to the European Commission published in February 2017 (EIOPA technical advice), EIOPA highlights the importance of taking into account the interests of consumers throughout the product lifecycle and states that it ‘considers that product oversight and governance arrangements play a key role in customer protection by ensuring that insurance products meet the needs of the target market and thereby mitigate the potential for miss-selling’. Accordingly, EIOPA has set out detailed requirements that it hopes will result in products that:

- meet the needs of one or more identified target markets;
- deliver fair outcomes for customers; and
- are sold to customers in the target markets by appropriate distribution channels.
Insurance based investment products

IBIPs are often made available to customers as potential alternatives or substitutes to investment products that are subject to MiFID. The IDD explains that to deliver consistent investor protection and to avoid the risk of regulatory arbitrage, it is important that IBIPs are subject, in addition to the conduct of business standards defined for all insurance products (set out above), to specific standards aimed at addressing the investment element embedded in those products.

The IDD, therefore, includes the following additional requirements applicable to insurance intermediaries and insurance undertakings who carry on insurance distribution in relation to the sale of IBIPs:

- prevention of conflicts of interest;
- conflicts of interest;
- information to customers; and
- assessment of suitability and appropriateness and reporting to customers.

An insurance product which offers a maturity or surrender value and where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations, and does not include:

- non-life insurance products as listed in Annex I of the Solvency II Directive (classes of non-life insurance);
- life insurance contracts where the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or disability;
- pension products which, under national law, are recognised as having the primary purpose of providing the investor with an income in retirement, and which entitle the investor to certain benefits;
- officially recognised occupational pension schemes falling under the scope of the Occupational Pensions Funds Directive (2009/138/EC); or
- individual pension products for which a financial contribution from the employer is required by national law and where the employer or the employee has no choice as to the pension product or provider.
**Management of conflicts of interest**

The IDD introduces higher standards of disclosure and conflict management for IBIPs and under the IDD, an insurance intermediary or an insurance undertaking carrying on the distribution of IBIPs must maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps to prevent conflicts of interest from adversely affecting the interests of its customers.

The new requirements on conflicts of interest are almost identical to the requirements originally introduced under MiFID II and accordingly EIOPA has based its current technical advice on its previous policy recommendations. Some changes, in particular with regard to the disclosure of conflicts of interest, have been introduced for the sake of consistency with the wording of the IDD.

Instances where conflicts of interest typically arise and which need to be appropriately managed by the insurance undertaking or insurance intermediary include the following:

- the insurance undertaking/insurance intermediary has an interest in selling products of its own group (eg funds contained in a unit linked product);
- the insurance undertaking/insurance intermediary is receiving sales commissions and/or follow up commissions;
- there is a horizontal conflict of interest between different customers, because there is higher demand for a specific life product than occasion for concluding of contracts/supply;
- the insurance undertaking/insurance intermediary is earning money in case of a change of funds during the lifetime of a unit-linked life insurance contract; or
- the insurance undertaking/insurance intermediary can have an interest to recommend or not to recommend a certain IBIP due to his own portfolio (own account trading).

Firms should, however, note that the disclosure of conflicts of interest should be understood as the step of last resort to be used only in cases where the organisational and administrative measures are not sufficient to effectively prevent and manage conflicts of interest. EIOPA highlights that ‘any overreliance on disclosure should be considered a deficiency in the conflicts of interest policy’.

**Information to customers**

The IDD requires an insurance intermediary or insurance undertaking who provides advice on an IBIP to a customer to carry out a suitability assessment determine the appropriateness of that product for the customer and to provide them with specific information.

**“Appropriate information”**

Prior to the conclusion of the contract, “appropriate information” must be provided in “good time” to customers or potential customers with regard to the distribution of an IBIP, and with regard to all costs and related charges. That information must include at least the following:

a) when advice is provided, whether the insurance intermediary or insurance undertaking will provide the customer with a periodic assessment of the suitability of the IBIP recommended to that customer;

b) as regards the information on IBIPs and proposed investment strategies, appropriate guidance on, and warnings of, the risks associated with the IBIP or in respect of particular investment strategies proposed; and

c) as regards the information on all costs and related charges to be disclosed, information relating to the distribution of the IBIP, including the cost of advice, where relevant, the cost of the IBIP recommended or marketed to the customer and how the customer may pay for it, also encompassing any third party payments.

The information about all costs and charges, including costs and charges in connection with the distribution of the IBIP, which are not caused by the occurrence of underlying market risk, must be provided in aggregated form to allow the customer to understand the overall cost as well as the cumulative effect on the return of the investment.
Where the customer requests an itemised breakdown of the costs and charges, this should also be provided. Where applicable, this information must be provided to the customer on ‘a regular basis’ and at least annually, during the life cycle of the investment.

**Form of information**

The information must be provided to customers in a comprehensible form so that customers or potential customers are reasonably able to understand the nature and risks concerning the IBIP offered and, consequently, to take investment decisions on an informed basis. Member states may allow that information to be provided in a standardised format.

For IBIPs a key information document (KID) will be required by the Regulation on KIDs for packaged retail and insurance-based investment products (PRIIPs) (Regulation 1286/2014) (PRIIPs Regulation). Distributors of IBIPs should provide additional information setting out any distribution costs that are not already included in the costs specified in the form of the KID under the PRIIPs Regulation.

**Assessment of suitability and appropriateness**

*Where advice is given*

When providing advice on an IBIP, the insurance intermediary or insurance undertaking must obtain the necessary information regarding the customer’s or potential customer’s knowledge and experience in the investment field relevant to the specific type of product or service.

This information is required to enable the insurance intermediary or the insurance undertaking to recommend to the customer or potential customer the IBIPs that are suitable for that person and that, in particular, are in accordance with that person’s risk tolerance and ability to bear losses.

Where customers or potential customers do not provide this information, or where they provide insufficient information regarding their knowledge and experience, the insurance intermediary or insurance undertaking is required to warn them that it is not in a position to determine whether the product envisaged is appropriate for them. That warning may be provided in a standardised format.

*Where no advice is given*

Where no advice is given in relation to IBIPs, member states may derogate from the obligations set out above by allowing insurance intermediaries or insurance undertakings to carry out insurance distribution activities within their territories without the need to obtain the information where certain conditions are satisfied. These conditions relate to the type of IBIP and whether the insurance distribution activity was carried out at the initiative of the customer.

**Reporting to customers**

Insurance intermediaries and insurance undertakings must establish a record that includes the document or documents agreed between them and the customer that set out the rights and obligations of the parties, and the other terms on which the insurance intermediary or insurance undertaking will provide services to the customer. The rights and duties of the parties to the insurance contract may be incorporated by reference to other documents or legal texts.

Firms also have to provide customers with adequate reports on the service provided on a ‘durable medium’. Those reports must include periodic communications to customers, taking into account the type and the complexity of IBIPs involved and the nature of the service provided to the customer including, where applicable, the costs associated with the transactions and services undertaken on behalf of the customer.
Comment

Although many of the requirements in the IDD already exist in the UK, it still represents a significant development in insurance regulation. It will result in a number of rule changes and a number of new requirements which may be burdensome for firms to implement. The provisions will also significantly extend the regulation of insurance sales in other EU countries.

The IDD is also aligned with and likely to encourage some important regulatory trends that we are seeing in the UK. For example, over time, the FCA’s interpretation of the UK requirement to treat customers fairly has become increasingly consistent with the sorts of obligations that arise in fiduciary relationships. The new IDD requirement for firms to act in the best interests of their customers, and the new rules relating to conflicts of interest, are likely to continue that trend.

The IDD is also aligned with a general movement in the UK to impose greater responsibility on firms shifting some of the responsibility away from customers in relation to product sales, in particular as regulators look for ways to address the absence of advice in particular areas of the market. One way this has been dealt with in the UK is through a more onerous interpretation of the general UK disclosure requirement to be clear, fair and not misleading. It will be interesting to see if other European jurisdictions develop the new IDD disclosure obligations in a similar way.

The new IDD requirements relating to product oversight and governance are also significant. We have recently seen the FCA interpret similar UK requirements in ways that make product providers responsible for issues which have traditionally sat with sellers and distributors, and there is a shift towards requiring firms to amend their contract terms (or provide ongoing information to customers) as the market and customer circumstances develop over time – and perhaps also to compensate customers when they have failed to do so. Again it will be interesting to see if the IDD encourages the UK regulator to further extend its approach to the responsibilities of product manufacturers and distributors, and whether other European jurisdictions interpret the new IDD requirements in a similar way.