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Consultation on the Review of the Insurance Mediation Directive (IMD) – A Cicero Consulting Special Report

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INTRODUCTION

The Insurance Mediation Directive (IMD) was adopted in 2002. Its aim was twofold: protect consumers through the establishment of professional requirements for insurance intermediaries, and enhance cross-border activity through a single passport.

Almost five years after the Directive had to be transposed into national law the Commission initiates a consultation anticipating a review in 2011, focusing greatly on consumer protection, bringing up the unpopular question among insurance intermediaries whether they should disclose the commission they receive for selling a product.

A closer look at the consultation reveals that the European Commission seeks to expand the scope of the Directive to include insurance undertakings and their employees in order to create a level playing field among all Member States. The reason would be that the minimum harmonisation has caused that consumers in some Member States are less protected when they buy a product directly rather than through an intermediary. Such an expansion could actually justify changing the name of the Directive!

However, most industry stakeholders will also look at this consultation with a different set of eyes, namely how will the review fit in the ongoing financial sector reform in the European Union? The increased transparency on selling practices to avoid conflicts of interests is clearly inspired on MiFID.

Indeed, nowadays a revision of a piece of EU financial regulation is never a stand-alone revision. In the IMD's case it is not only foreseen in Solvency II, but it is also influenced by other insurance products, such investments that are packaged as life insurance policies (insurance PRIPs).

The Commission launched a separate consultation on the protection of retail customers in PRIPs on 26 November. In that consultation the Commission suggests that the European rules on consumer protection for most other retail investment products (the Packaged

Retail Investment Product or PRIPs legislation), should be implemented through MiFID and through the Insurance Mediation Directive. A new PRIPs regime would in the Commission's view be too complex, costly, and confusing.

All these ongoing developments make it obvious that it is unsurprising that the European Commission is suffering under the time pressure imposed by the various legislative proposals and reviews. The longly anticipated MiFID review that was expected in Autumn but now is likely to have been postponed until mid-December 2010 is just an example.

It remains to be seen whether the current myriad of legislative proposals aimed to increase consumer protection and to decrease legal uncertainly will actually do what they are supposed to do, and not the exact opposite.

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Consultation Summary

Introduction

Insurance intermediaries have an important role to play in the distribution of insurance products. In order to ensure consistent rules on consumer protection, Directive 2002/92/EC of the European Parliament and the Council on insurance mediation (IMD) was adopted in 2002 to be transposed by 15 January 2005.

However, due to its minimum harmonisation approach the Directive created a patchwork of national regulations, leading to gaps and inconsistencies. In addition to these gaps, the introduction of Solvency II will affect the relationship between insurance undertakings and policy holders, which is why the Solvency II Directive calls for a review of the IMD.

The Commission recognizes that selling practices in connection with certain financial products have also demonstrated to be deficient during the crisis, and therefore intends to address cross-sectoral inconsistencies regarding the marketing of investment products through a review of the Packaged Retail Investment Products (PRIPs) legislation, for which a separate consultation was launched on 26 November 2010.

In this light the Commission notes that two regimes would appear necessary in the reviewed IMD:

1. A regime for the sale of general insurance products
2. A regime for insurance PRIPs, i.e. investments packaged as life insurance policies

The revision of the IMD would therefore consist of two parts:

A. A revision of the IMD provisions in light of the implementation review mentioned above
B. The introduction of MiFID-inspired conduct of business and conflicts of interest rules regulating the sale of insurance PRIPS.

CEIOPS published its final report with advice on the IMD review on 11 November.

2.1 Purpose and Scope

The purpose of this consultation is to collect views from all stakeholders concerned on the necessary changes to address the main weaknesses in the current IMD. According to the implementation check after the transposition deadline in 2005, practice varies between Member States on the interpretation of the cumulative conditions regulating exemptions from the IMD's scope.

In addition, the Commission services also launched a questionnaire focusing on specific areas of the IMD, the outcome of which highlighted that the application of the IMD varies considerably between Member States leading to problems with information requirements, legal certainty, professional requirements, management of conflicts of interests and transparency rules.

2.2 What are the main problems identified?

Consumers often have insufficient understanding of the risks, costs and features of insurance products, while sellers can be subject to significant conflicts of interests, for example in terms of remuneration. In the Commission's view the revision of the IMD should therefore focus on four key problems:

2.2.1. Insufficient quality of information provided to consumers

The Commission notes that the information given to consumers varies significantly in quality, (dense, legalistic, full of jargon and difficult to digest), depending on the product and the regulatory requirements which also vary per Member State.

Consumers are also not always fully informed of their rights. Lastly, the overlap in pre-contractual information requirements resulting from the various insurance directives (Solvency II, the E-Commerce Directive and Distance Marketing of Financial Services Directive) cause uncertainty and increase administrative burdens for national supervisory authorities, insurance intermediaries, insurance undertakings and consumers.

2.2.2. Conduct of business rules: conflicts of interest and transparency

The current wording of the IMD directive is unclear regarding conflicts of interest and transparency. The Commission notes that existing provisions are insufficient and that effective rules on conflict of interests should be introduced as these may compromise the objectivity of the advice given.

In addition, the current IMD does not contain provisions on remuneration, and in the Commission's view the financial crisis has highlighted the need to provide more comprehensive information and transparency.

Lastly the Commission states that national conduct of business models in place in Member States are divergent and notes the desire for a level playing field.

2.2.3. Legal uncertainty due to unclear definition of scope in the IMD

The Commission finds that the definition of insurance intermediation built on the activity based principle seems to conflict with the definition of the scope of the IMD and related provisions. More importantly, the exclusion of insurance undertakings and their employees from the scope implies that consumers may receive less information when they buy a product directly from insurance undertakings rather than through an intermediary.

2.2.4. Burdensome notification system

The implementation check revealed that the notification system through which insurance intermediaries announce their activities beyond their home Member States, does not encourage cross-border insurance intermediation, limiting consumer choice and negatively impacting the competitiveness of the insurance markets.

2.3 SME aspects and administrative burden

The Commission notes that the IMD revision will take note of the overall objective of reducing the administrative burden.

3. Elements of the proposed approach

3.1 Policy Objectives

According to the European Commission the revision of the IMD should aim at addressing the following objectives:

A. A high and consistent level of policy holder protection embodied in EU law.
B. Effective management of conflicts of interest and transparency
C. Introducing clearer provisions on the scope of the IMD
D. Increased efficiency in cross-border business
E. Achieve a higher level of professional requirements

The tentative options of the Commission are set out in boxes.

A –A high and consistent level of policy holder protection embodied in EU law
The Commission notes that information for policy holders should be relevant, clear, comprehensive accurate, fair and not misleading.

The Commission considers it logical to require similar requirements from insurance undertakings and insurance intermediaries when distributing insurance policies, taking into account the specificities of existing distribution channels.

B – Effective management of conflicts of interest and transparency
One of the objectives of the revision of the IMD should be to adopt clear and effective rules on conflicts of interests and transparency which affect the distribution of all insurance products. Insurance intermediaries should be obliged to act honestly, professionally and in line with the interests of their customers. Another objective should be to establish a more robust EU disclosure framework which should lead to a higher degree of harmonisation.

The revision of the IMD should take into account the MiFID rules on conflict of interests, transparency and inducements, also since these have been identified as a benchmark for the distribution of insurance PRIPs.

Following the Report on the Business Insurance Sector Inquiry 2007 the Commission will also look into the dual role of brokers as both advisor to clients and as distribution channel for the insurer, in view of possible conflicts of interest.

The current provisions in the IMD would not appear sufficiently clear and effective to mitigate significant conflicts of interest. Therefore, it would appear appropriate to revise the current rules.

The application of the high level principles concerning conflicts of interest and transparency both to insurance intermediaries and insurance undertakings could be considered.

In this context, one option could be to use the MiFID Level 1 regime as a starting point for the management of conflicts of interest, notably with regard to remuneration. In addition requirements regarding the disclosure of remuneration could be introduced.

C. - Introducing clearer provisions on the scope of the IMD

The Commission notes that guaranteeing a real level playing field between all participants involved in the selling of insurance products is another objective of the revision. This would mean extending the scope to insurance undertakings and their employees, as well as considering the differences between on the one hand investments packaged as life insurance policies (insurance PRIPs) and other categories on the other hand.

The extended scope should also include sales of insurance products by means of distance marketing.

It would be appropriate to retain the activity-based definition of insurance intermediation. It is suggested that exemptions from the scope should be activity-based and not based on types of "professions" e.g. travel agents. Reinsurance intermediaries should remain within the scope of the IMD. In addition, "direct sales" by insurance undertakings and their employees could also be included.

Finally, where an insurance undertaking (A) sells the products of another insurance undertaking (B), A should be considered to be the intermediary of B and subject to the provisions relating to insurance intermediaries.

D – Increased efficiency in cross border business

The Commission services believe that the practical application of the notification system needs to be reshaped in terms of its efficiency and operation. To this end, the Commission considers integrating the definition on freedom to provide services (already included in CEIOPS' Luxembourg protocol), and to link this to the freedom to provide services and the general good in the insurance sector.

The "single passport" under IMD is based on the principle of registration in the home Member State. It would appear appropriate to improve the legal framework in relation to the notification process and integrate the definitions on FOS and FOE into the IMD in order to render the cross border insurance intermediation process more effective. This includes a more transparent use of the general good rules. It would also appear appropriate to include the mutual recognition clause in the CEIOPS Luxembourg Protocol in the IMD.

E – Achieve a higher level of professional requirements

It would appear appropriate to establish basic common principles for professional requirements for all sellers of insurance products. In this context, one option would be to consider imposing a Member State requirement to ensure that all persons in insurance undertakings who are responsible for insurance distribution and sales in respect of insurance products, as well as all other employees directly involved in insurance or

reinsurance distribution or sales, demonstrate the knowledge and ability necessary for the performance of their duties.

3.2 Distribution of insurance PRIPs (investments packaged as life insurance policies)

In the context of PRIPS, it would appear important to ensure that consistent conduct of business, inducements and conflict of interest rules are applied to all persons selling packaged retail investment products, irrespective of whether the relevant entity is an intermediary or whether it is the product originator. Detailed requirements should take into account the service being offered (advice, sales without advice). However, it is vital that market failings or risks for customers should be always be addressed in an effective or appropriate manner, irrespective of the channel through which a sale is being concluded. The rules of MiFID would appear to be the appropriate benchmark in this regard. The person selling insurance PRIPs should be responsible for providing precontractual disclosure document(s) to the client. As regards direct sales, the responsibility would fall on the product originator (PRIPS insurer). For indirect sales, the intermediary would be responsible for providing the document to the client.

In respect to the sales process and any services provided in relation to that process, the following main principles should be considered:

- Insurers or insurance intermediaries selling or giving advice on insurance PRIPs should act honestly, fairly and professionally in accordance with the best interests of their clients. In the context of tied agents, the responsibility to act in the best interest of the client would remain with the insurance undertaking.
- Insurance undertakings or insurance intermediaries selling PRIPs need to ensure that the client receives information as regards the remuneration of the sellers (making clear the difference between the premium paid and the actual invested part of the premium). Remuneration structures should not be such that they materially impact on the ability of the intermediary to act in the best interest of the client and should be structured in a way that effectively avoid or manage any conflicts of interest that may arise.

- When providing investment advice for insurance PRIPs, the insurance intermediary or the insurer should obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, his financial situation and his investment objectives. This information should be obtained so as to enable the firm to recommend to the client or potential client the investment services and financial instruments that are suitable for that client or potential client.
- Member States could be required to ensure that the insurance intermediary and the insurer, when selling insurance PRIPs without providing advice, ask the client or potential client to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or requested. This information request should enable the insurance intermediary or the insurer to assess whether the investment service or product envisaged is appropriate for the client. If the insurer or intermediary considers, on the basis of the information received, that the product or service is not appropriate to the client or potential client, the insurer or intermediary should warn the client or potential client. This warning could be provided in a standardised format.

Member States could be required to ensure that insurance intermediaries and insurers take all reasonable steps to identify conflicts of interest between themselves. This should include conflicts in relation to the intermediaries' or insurers' managers, employees and tied intermediaries, or any person directly or indirectly linked to them by control and their clients or between one client and another that arise in the course of providing any insurance, insurance intermediation and ancillary services related to PRIPs insurance policies.

Where organisational or administrative arrangements put in place by the insurance intermediary or the insurer to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to client interests will be prevented, the PRIPs intermediary and insurer could be required to clearly disclose the general nature and/or

sources of conflicts of interest to the client before undertaking business on the client's behalf.

Questions asked in the consultation

A- A high and consistent level of policy holder protection embodied in EU law

A 1. Do you agree with the Commission services general approach outlined above? Should information requirements as contained in Article 12 of the IMD be extended to direct writers taking into account the specificities of existing distribution channels?

A 2. Should the exemption from information requirements for large risk insurance products as laid down in Article 12 (4) of the IMD be retained? Please provide reasons for your reply.

A 3. In the context of the information requirements for the mediation of insurance products other than PRIPs, do you think that the possibility for Member States to impose stricter requirements should be maintained? Please provide reasons for your reply.

A 4. In the context of the information requirements, do you think a definition of "advice" should be introduced? Please provide reasons for your reply.

A 5. If you think that a definition of advice is needed for the mediation of insurance products other than PRIPs, would a definition similar or identical to the definition in MiFID be appropriate? Please provide reasons for your reply.

A 6. Do you consider that certain insurance products (other than PRIPs) can be sold without advice? If yes, which products would you have in mind and how could possible detriment for consumers be mitigated?

A 7. What practical measures could be envisaged for reducing the administrative burden in this area?

B- Effective management of conflicts of interests and transparency

B 1. What high level principles would you propose to effectively manage conflicts of interest, taking into account the differences between investments packaged as life insurance policies and other categories of insurance products?

B 2. How could these principles be reconciled for all participants involved in the selling of insurance products?

B 3. Do you agree that the MiFID Level 1 regime could be regarded as starting point for the management of conflicts of interests? If not, please explain why.

B.4. How can the transparency of remuneration in the sale of non-PRIPS insurance policies be improved for all participants involved in the selling of insurance products, taking into account the need for a level playing field?

B 5. Do you agree that all insurance intermediaries should have the right to be treated equally in terms of the structure of their remuneration, e.g. that brokers should be allowed to receive commissions from insurance undertakings as insurance agents?

B. 6. What conditions should apply to disclosure of information on remuneration?

B. 7. What types/kinds of remuneration need to be included in the information on remuneration?

C – Introducing clearer provisions on the scope of the IMD

C 1. In order to guarantee a real level playing field between all participants involved in the selling of insurance products, to what extent should the current IMD requirements also be applicable to direct writers and their employees? Please, specify which particular requirements should apply and reflect on the particularities of direct sales with examples (how, where, under what circumstances, etc.)

C 2. A lack of clarity about the scope of the IMD could lead to unnecessary administrative burden. What are the possible clarifications that could be brought to the current scope of the IMD in this respect?

C 3. What conditions/reasons for exemption from IMD2 should be in place taking into account the need to ensure legal certainty and consumer protection?

C 4. Should a website or a person who just gives information about insurance fall under the scope of the IMD? How could the boundaries be more clearly defined in respect to insurance intermediation?

C 5. Do you have examples of activities which, in the majority of Member States, fall under the IMD but which you believe should not be covered, such as sales of certain insurance products by car rental companies? Or conversely, do you have examples of activities which currently do not fall under the IMD but which should be covered?

C 6. Which particular requirements stemming from the Directive on the Distance Marketing of Financial Services (DMFS) need to be taken into account in IMD2? How does the definition of supplier in the DMFS Directive affect the definition of insurance intermediation?

D – Increased efficiency in cross-border business

D 1. Do you agree with the inclusion of the definition of the freedom to provide services (FOS), as laid down in the Luxembourg Protocol of CEIOPS21, in the text of the IMD?

D 2. Is there a need to further clarify the rules regarding freedom of establishment (FOE) and integrate these rules in the IMD?

D 3. How can the notification process be made more efficient and useful?

D 4. Do you agree that further rules on FOS and FOE should be included in a revised IMD in order to provide more legal certainty?

D 5. Are there any issues with regard to the general good rules in relation to the cross-border dimension of insurance intermediation? If so, please provide further details.

D 6. What problems do insurance intermediaries face today when selling cross border? How should the IMD be amended to improve the conditions for FOE/FOS activities?

D 7. Would the integration of the CEIOPS Luxembourg Protocol clause on mutual recognition in a revised IMD be useful in this respect?

D 8. Could provisions similar to those contained in the E-Commerce Directive regarding an appropriate and transparent use of general good rules be integrated into the IMD2?

E – Achieve a higher level of professional requirements

E 1. What high level requirements on the knowledge and ability of all participants involved in the selling of insurance products would be appropriate in view of the existing differences in the applicable qualification systems in Member States?

E 2. Should these requirements be adapted according to the distribution channel? If so, how?

General questions on section 3.2 – Distribution of insurance PRIPs (investments packaged as life insurance policies)

1. What practical challenges do you think should be addressed when drafting new legislation on the distribution of insurance PRIPs?

2. What are the most important practical issues to be considered when applying the MiFID benchmark to the selling of insurance PRIPs?

ABOUT CICERO CONSULTING

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