



EIOPA-17/048
1 February 2017

Technical Advice on possible delegated acts concerning the Insurance Distribution Directive

Table of Contents

1. UNDERLYING STRATEGIC OBJECTIVES OF EIOPA’S POLICY PROPOSALS	3
2. BACKGROUND	5
3. PRODUCT OVERSIGHT & GOVERNANCE	8
4. CONFLICTS OF INTEREST	33
5. INDUCEMENTS	40
6. ASSESSMENT OF SUITABILITY AND APPROPRIATENESS AND REPORTING TO CUSTOMERS	50
7. EXECUTION-ONLY SALES - CRITERIA TO ASSESS “OTHER NON-COMPLEX INSURANCE-BASED INVESTMENT PRODUCTS”	72
ANNEX I: IMPACT ASSESSMENT	78

1. Underlying Strategic Objectives of EIOPA's policy proposals

1. On 24 February 2016, EIOPA was asked with a formal "Request for Advice" by the European Commission to provide technical advice on possible delegated acts to further specify the following provisions of the Insurance Distribution Directive (IDD):
 - Product Oversight and Governance, Article 25, IDD;
 - Conflicts of Interest, Articles 27 and 28, IDD;
 - Inducements, Article 29(2), IDD; and
 - Assessment of suitability and appropriateness and reporting, Article 30, IDD.
2. EIOPA places consumer protection, both through prudential and conduct of business regulation, at the centre of its strategy. Misconduct by firms may not only harm individual consumers, but may also have a wider prudential impact, posing a threat to the stability of the financial sector. Notwithstanding the fact that the Commission requests advice of a technical nature from EIOPA, EIOPA sees this advice as also actively contributing to the completion of a single rulebook on consumer protection, namely through the implementation of the IDD.
3. EIOPA has developed its policy proposals in view of EIOPA's strategic objectives and priorities as outlined in EIOPA's annual work programme for 2016¹, in particular the objective *"to ensure transparency, simplicity, accessibility and fairness across the internal market for consumers"*.
4. In this respect, the focus is on the objectives, firstly, to *"provide a framework for better governance, suitability and accessibility of insurance products for consumers"* and, secondly to *"develop a framework for proper selling practices for direct sellers and intermediaries ensuring that advice to consumers is based on what best suits their needs and profiles"*.
5. The detailed policy proposals on product oversight and governance arrangements pursue the first objective to provide a framework for better governance of insurance products. They aim to ensure that the interests of customers are taken into consideration throughout the life cycle of a product, namely the process of designing and manufacturing the product, bringing it to the market and monitoring the product once it has been distributed. The inclusion of the provisions of EIOPA's Product Oversight & Governance (POG) Preparatory Guidelines in the technical advice, is in line with EIOPA's objective of the Guidelines providing early guidance and supporting national authorities and market participants with the implementation of POG requirements in preparation for the formal requirements provided for in the IDD.
6. The policy proposals on conflicts of interest, inducements as well as suitability/appropriateness assessment pursue the second objective. They aim to ensure that distribution activities are carried out in accordance with the best interests of customers and that customers buy insurance products which are suitable and appropriate for the individual customer.
7. Taking into consideration that inducements have the potential to cause a conflict of interest between the interests of distributors and their customers, the policy

proposals aim to ensure that any detrimental impact, stemming from the payment of inducements, on the quality of the service provided to the customer is mitigated from the outset.

8. The policy proposals further specifying the suitability/appropriateness assessment, ensure that the insurance intermediary or insurance undertaking obtains all relevant information necessary to assess whether a specific insurance-based investment product is suitable or appropriate for a specific customer. This approach helps, for example, to ensure that insurance intermediaries or insurance undertakings do not request more information from the customer than needed to provide good quality advice to the customer or information requests are not duplicated. This will further enhance the quality of service provided to the customer, thereby strengthening the framework for proper selling practices.

2. Background

1. On 30 June 2015, the European Parliament and the Council Presidency reached an agreement on a draft Directive establishing new improved rules on insurance distribution (the "Insurance Distribution Directive" – hereafter "IDD")². Subsequent to this trilogue agreement being reached, the final legislative proposals of the IDD were approved by the European Parliament on 24 November 2015 and by the Council of the EU on 14 December 2015. The IDD was published on 2 February 2016 in the Official Journal of the European Union and entered into force on 23 February 2016.
2. The deadline for Member States transposing IDD is 23 February 2018. IDD effectively replaces the Insurance Mediation Directive (IMD)³ as the IMD is repealed from the date of transposition. In addition, the amendments made to the Insurance Mediation Directive (IMD) via Article 91 of Directive 2014/65/EC ("MiFID II") were also deleted from the IMD with effect from 23 February 2016.
3. The IDD establishes new rules on insurance distribution and seeks to:
 - Improve regulation in the retail insurance market and create more opportunities for cross-border business;
 - Establish the conditions necessary for fair competition between distributors of insurance products, for example, through an extension of the Directive to direct sales; and
 - Strengthen consumer protection, in particular with regard to the distribution of insurance-based investment products (IBIPs).
4. Certain elements of the IDD need to be further specified in delegated acts to be adopted by the Commission. These include:
 - Product Oversight and Governance (Article 25(2));
 - Conflicts of Interest (Article 27 and 28(4));
 - Inducements (Article 29(4)); and
 - Assessment of suitability and appropriateness and reporting to customers (Article 30(6)).
5. EIOPA received a formal request ("Mandate")⁴ from the European Commission on 24 February 2016 to provide technical advice to the Commission by 1 February 2017 on the possible content of the delegated acts.
6. The Commission invited EIOPA to build on the results of previous work that has already been carried out by EIOPA (e.g. EIOPA's previous technical advice on

² Directive 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast): <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L0097&from=EN>

³ Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation

⁴ Request for EIOPA Technical Advice on possible delegated acts concerning the Insurance Distribution Directive: <https://eiopa.europa.eu/Publications/Requests%20for%20advice/I-EIOPA-2016-073%20COM%20Letter%20IDD%20%28GBE%29.pdf>

conflict of interests in direct and intermediated sales of insurance-based investment products ("IMD 1.5")⁵ and EIOPA's Preparatory Guidelines on Product Oversight & Governance arrangements by insurance undertakings and insurance distributors⁶).

7. In addition, EIOPA was invited under the Commission's mandate to achieve as much consistency as possible in the conduct of business standards for insurance-based investment products under IDD on the one hand and financial instruments under MiFID II on the other, where there is no fundamental difference in the wording of the provisions in the IDD and corresponding provisions in MiFID II.
8. As regards MiFID II, the following draft delegated acts are of relevance to the technical advice on the delegated acts on IDD and have been adopted by the Commission:
 - Draft Commission Delegated Directive supplementing Directive 2014/65/EU with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits⁷;
 - Draft Commission Delegated Regulation supplementing Directive 2014/65/EU as regards organisational requirements and operating conditions for investment firms as defined terms of the purposes of that Directive⁸.
9. In order to provide stakeholders with an early orientation on issues that will need to be addressed in the technical advice to the Commission and to gather feedback from the market, EIOPA published an online survey in January 2016 (the results of which have also been published online)⁹.

Cost-benefit analysis

10. EIOPA was requested by the Commission to support its Technical Advice to the Commission with data and evidence on the potential impacts of proposals identified, including an assessment of the relative impacts of different options where this is appropriate. Where impacts might be substantial, the Commission requested, where feasible, that EIOPA provide quantitative data. The provision of such data and evidence will aid the Commission in preparing an Impact Assessment on the measures it shall adopt.

⁵ [https://eiopa.europa.eu/Publications/Opinions/EIOPA-15-135_Technical%20Advice%20%20Impact%20Assessment_conflicts_of_interest_version%20for%20COM%20\(2\).pdf](https://eiopa.europa.eu/Publications/Opinions/EIOPA-15-135_Technical%20Advice%20%20Impact%20Assessment_conflicts_of_interest_version%20for%20COM%20(2).pdf)

⁶ Final Report on the Public Consultation on Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and distributors:

<https://eiopa.europa.eu/Publications/Reports/Final%20report%20on%20POG%20Guidelines.pdf>

⁷ COMMISSION DELEGATED DIRECTIVE (EU) .../... of 7.4.2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits

⁸ COMMISSION DELEGATED REGULATION (EU) .../... of 25.4.2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

⁹ <https://eiopa.europa.eu/Pages/Consumer-Protection/Online-survey-Call-for-Advice-from-EC-IDD.aspx>

11. EIOPA has included a high-level assessment of possible impacts in Annex I. In developing this submission, EIOPA has also built upon the responses/data received to the public consultation on the costs and benefits of its proposals, the impact assessment work undertaken by the Commission for the revisions of the IMD and MiFID.

Next Steps

12. EIOPA will submit the Technical Advice and Impact Assessment to the European Commission by 1 February 2017 in accordance with the Commission's Request for Advice.

13. EIOPA will monitor the issues raised in this technical advice and assess, on the basis of sound evidence following the implementation of the Level 1 and Level 2 provisions in IDD in February 2018, the need for issuing guidance to further specify particular issues raised in this technical advice.

3. Product Oversight & Governance

Background/Mandate

Extract from the European Commission's request for advice

"EIOPA is invited to provide technical advice on detailed product oversight and governance arrangements for insurance undertakings and insurance intermediaries manufacturing and distributing insurance products in order to avoid and reduce, from an early stage, potential risk of detriment to customers' interest. The technical advice should identify when insurance undertakings and insurance intermediaries are acting as manufacturers, distributors, or both, and establish the level of responsibility of those actors. In addition, the technical advice should take into account the different types of distribution channels and differences in the size of the insurance undertaking or insurance intermediary concerned. EIOPA should also address the question of how the nature of the insurance product could be taken into consideration in terms of the practical application of the product oversight and governance arrangements.

With regard to product manufacturers, the technical advice should in particular deal with the arrangements of designing, approving and marketing insurance products, including the manufacturers' ongoing obligations as regards the life cycle of insurance products. In identifying the target market of customers, the technical advice should detail the level of granularity expected from manufacturers as regards the complexity of the insurance product and whether it is intended for mass market distribution. The technical advice should provide examples for activities that can be considered "manufacturing an insurance product for sale to customers".

With regard to insurance distributors, the technical advice should in particular deal with the arrangements for selecting insurance products for distribution to customers as well as for obtaining all the relevant information on the insurance product from the manufacturer in order to provide the distribution activities in accordance with the obligation to act in the best interest of the customer. EIOPA should assess whether distributors should be required to periodically inform the manufacturer about their experience with the product, or whether information on an incidental basis reflecting specific changes in the market would ensure sufficient protection of the customer's interest.

The technical advice should also specify the obligation for manufacturers and distributors of insurance products to regularly review their product governance policies as well as the products they manufacture, offer or recommend. The technical advice should refer to any appropriate actions to be taken by manufacturers and, where appropriate, distributors, to prevent and mitigate detriment to the interests of customers. Strengthening the role of management bodies and, where applicable, the compliance function, to ensure compliance with the arrangements should be duly considered."

1. The relevant provisions in the Insurance Distribution Directive are:

Recital 55:

"In order to ensure that insurance products meet the needs of the target market, insurance undertakings and, in the Member States where insurance intermediaries manufacture insurance products for sale to customers, insurance intermediaries should maintain, operate and review a process for the approval of each insurance product. Where an insurance distributor advises on, or proposes, insurance products which it does not manufacture, it should in any case be able to understand the characteristics and identified target market of those products. This Directive should not limit the variety and flexibility of the approaches which undertakings use to develop new products".

Article 25:

"1. Insurance undertakings, as well as intermediaries which manufacture any insurance product for sale to customers, shall maintain, operate and review a process for the approval of each insurance product, or significant adaptations of an existing insurance product, before it is marketed or distributed to customers.

The product approval process shall be proportionate and appropriate to the nature of the insurance product.

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

The insurance undertaking shall understand and regularly review the insurance products it offers or markets, taking into account any event that could materially affect the potential risk to the identified target market, to assess at least whether the product remains consistent with the needs of the identified target market and whether the intended distribution strategy remains appropriate.

Insurance undertakings, as well as intermediaries which manufacture insurance products, shall make available to distributors all appropriate information on the insurance product and the product approval process, including the identified target market of the insurance product.

Where an insurance distributor advises on, or proposes, insurance products which it does not manufacture, it shall have in place adequate arrangements to obtain the information referred to in the fifth subparagraph and to understand the characteristics and identified target market of each insurance product.

2. The Commission shall be empowered to adopt delegated acts in accordance with Article 38 to further specify the principles set out in this Article, taking into account in a proportionate way the activities performed, the nature of the insurance products sold and the nature of the distributor.

3. The policies, processes and arrangements referred to in this Article should be without prejudice to all other requirements under this Directive including those relating to disclosure, suitability or appropriateness, identification and management of conflicts of interest, and inducements.

4. This Article does not apply to insurance products which consist of the insurance of large risks."

Policy work of ESMA and EBA

2. For the purpose of cross-sectoral consistency, EIOPA has taken into account the initial policy work carried out in the Joint Committee of the ESAs on manufacturers' product oversight & governance processes¹⁰ and policy work which ESMA and EBA developed with regard to product and oversight arrangements for credit institutions and investment firms, in particular ESMA's opinion on Structured Retail Products – Good Practices for product governance arrangements¹¹ and its technical advice to the Commission on MiFID II¹² and EBA's Guidelines on product oversight and governance arrangements for retail banking products¹³.
3. Furthermore, it should be noted that the Commission recently published its proposal for a Delegated Directive specifying the product oversight and governance requirements which investment firms have to fulfil under MiFID II which was taken into consideration when drafting this Consultation Paper.¹⁴

Introduction

4. EIOPA has been invited by the Commission to provide technical advice on detailed product oversight and governance arrangements for insurance undertakings and insurance intermediaries manufacturing and distributing insurance products.
5. **EIOPA 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 mis-selling.**
6. Product oversight and governance arrangements aim to ensure that the consumers interests are taken into consideration throughout the life cycle of a product, namely the process of designing and manufacturing the product, bringing it to the market and monitoring the product once it has been distributed. They are an essential element of the new regulatory requirements under IDD. Because of their relevance in terms of customer protection, it is of utmost importance that the new requirements are further detailed and specified.
7. Product oversight and governance arrangements are complementary to the information requirements and conducts of business rules applicable at the point of sale when carrying out distribution activities towards the individual customers.
8. It should be noted that EIOPA has already thoroughly elaborated policy proposals in the context of drafting Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and insurance distributors¹⁵.

¹⁰ https://eiopa.europa.eu/Publications/Administrative/JC-2013-77_POG - Joint Position .pdf

¹¹ https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-332_esma_opinion_u_structured_retail_products_-_good_practices_for_product_governance_arrangements.pdf

¹² https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-549_-_consultation_paper_mifid_ii_-_mifir.pdf

¹³ <https://www.eba.europa.eu/documents/10180/1141044/EBA-GL-2015-18+Guidelines+on+product+oversight+and+governance.pdf>

¹⁴ COMMISSION DELEGATED DIRECTIVE (EU) .../...of 7.4.2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits: <https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2031-EN-F1-1.PDF>

¹⁵ Final Report on Public Consultation on Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and insurance distributors: <https://eiopa.europa.eu/Pages/Guidelines/Preparatory-Guidelines-on-product-oversight-and-governance-arrangements-by-insurance-undertakings-and-insurance-distributor.aspx>

In the course of this process, EIOPA conducted two public consultations in order to appropriately involve market participants and stakeholders in the development of policy proposals.¹⁶ This work has originally been initiated following the Joint Position of the European Supervisory Authorities on Manufacturers' Product Oversight and Governance Processes¹⁷. In its Request for Advice, the Commission has explicitly asked to "build on the results of previous work such as the Preparatory Guidelines".

9. After a thorough analysis of the legal requirements in Article 25, IDD and the request of the Commission for technical advice, EIOPA has come to the conclusion that the Preparatory Guidelines entail general principles which are consistent with the IDD and therefore can be used to further specify the product oversight and governance requirements in Article 25, IDD. However, following the analysis of the Commission request, EIOPA has identified several issues which have not yet been addressed by the Preparatory Guidelines so far. For that reason, EIOPA has developed additional policy proposals which amend and have been consolidated with the existing policy proposals based upon the Preparatory Guidelines.

¹⁶ First public consultation:
<https://eiopa.europa.eu/Pages/Consultations/CP-14150-Guidelines-on-product-oversight-amp;-governance-arrangements.aspx>

Second public consultation:
<https://eiopa.europa.eu/Pages/Consultations/EIOPA-CP-15-008-Consultation-Paper-on-POG-Guidelines-for-insurance-undertakings-and-insurance-distributors-.aspx>

¹⁷ [https://www.eba.europa.eu/documents/10180/15736/JC-2013-77+\(POG+--+Joint+Position\).pdf](https://www.eba.europa.eu/documents/10180/15736/JC-2013-77+(POG+--+Joint+Position).pdf)

Analysis

10. The policy proposals distinguish between:
 - (i) Policy proposals for insurance undertakings and insurance intermediaries which manufacture insurance products for sale to customers (also referred to as “product oversight and governance arrangements”), and
 - (ii) Policy proposals for insurance distributors which distribute insurance products which they do not manufacture (also referred to as “product distribution arrangements”).
11. This is in line with the approach proposed by the Commission with regard to the draft Delegated Directive specifying the product oversight and governance requirements which investment firms have to fulfil under MiFID II.¹⁸ For the purpose of developing a consistent set of rules for the insurance sector, it is worth noting that the Commission proposes implementing measures with a high level of detail for both manufacturers, as well as distributors which are based upon high-level principles or specific obligations in MiFID, similar to those required under IDD.
12. Article 25 of the IDD introduces general principles regarding the product oversight and governance requirements, for insurance undertakings and insurance intermediaries which manufacturer insurance products for sale to customers, and for insurance distributors which distribute insurance products which they do not manufacture.
13. EIOPA would like to point out that the product oversight and governance arrangements applicable to insurance undertakings that manufacture insurance products are closely linked to the requirements regarding the system of governance as laid down in Articles 40 and 41(1) of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (hereinafter “Solvency II”). These Articles require insurance undertakings to have a sound and prudent management of the business under a risk-based approach including an appropriate risk management system.
14. In order to further specify the general principles on product oversight and governance requirements which underlie Article 25, IDD, EIOPA considers it important to define in more detail, the arrangements regarding internal processes, functions and strategies for designing and bringing products to the market, monitoring and reviewing them over their life cycle. The arrangements differ depending on the question whether the regulated entities are acting as a manufacturer and/or distributor of insurance products. In the case of manufacturers, these steps include:
 - (i) identifying a target market for which the product is considered appropriate;
 - (ii) identifying market segments for which the product is not considered appropriate;
 - (iii) carrying out product analysis to assess the expected product performance in different stressed scenarios;
 - (iv) carrying out product reviews to check if the product performance may lead to customer detriment and, in case this occurs, take actions to change its characteristics and minimise the detriment;

¹⁸ <https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2031-EN-F1-1.PDF>

- (v) identifying the relevant distribution channels taking into account the characteristics of the target market and of the product;
 - (vi) verifying that distribution channels act in compliance with the manufacturer's product oversight and governance arrangements; and
 - (vii) the provision of appropriate information on the product and the product approval process to insurance distributors.
15. The product oversight and governance arrangements should be generally applied to all insurance undertakings and all insurance intermediaries manufacturing insurance products, including any natural or legal person pursuing the activity of insurance distribution, independent from the question whether these activities are pursued by an independent broker or by a tied agent, provided that they fall into the scope of the IDD. However, product oversight and governance arrangements need to be proportionate to the level of complexity and the risks related to the products as well as the nature, scale and complexity of the relevant business of the regulated entity.
16. Product oversight and governance arrangements are without prejudice to basic principles in insurance, in particular the principles of solidarity, mathematical methods and risk pooling. The interests of customers that need to be taken into account when designing products following the product oversight and governance arrangements, comprise individual and collective policyholder interests which need to be duly balanced.

a. Analysis for arrangements applicable to manufacturers

17. The arrangements apply to all insurance undertakings and insurance intermediaries which manufacture any insurance product for the sale to customers.

Establishment and objectives of product oversight and governance arrangements

18. The manufacturer should establish, implement and review product oversight and governance arrangements that set out appropriate measures and procedures aimed at designing, monitoring, reviewing and distributing products for customers. The product oversight and governance arrangements should aim to prevent or mitigate customer detriment, support proper management of conflicts of interest and should ensure that the customer's demands and needs, and if relevant their knowledge and experience in the investment field, their financial situation and investment objectives and other relevant characteristics are duly taken into account already at the stage when the insurance products are designed and manufactured.
19. Good implementation of product oversight and governance arrangements should 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.
20. An application of product oversight and governance arrangements should also ensure that all relevant staff members have knowledge of these arrangements and

monitor them for their respective area of activities. It also ensures that any changes to the arrangements are promptly communicated to them.

Role of Management

21. The administrative, management or supervisory body of the manufacturer or equivalent structure (in the case of two tier systems) is ultimately responsible for the establishment, subsequent reviews and continued compliance of the product oversight and governance arrangements. The manufacturer's administrative, management or supervisory body also ensures that the product oversight and governance arrangements are appropriately designed and implemented into the governing structures of the manufacturer.
22. The product oversight and governance arrangements, as well as any material changes to those arrangements, are subject to prior approval by the manufacturer's administrative, management or supervisory body or equivalent structure.

Acting as Manufacturer

23. Article 25(1), IDD acknowledges that, in certain circumstances, insurance intermediaries can be involved in the manufacturing of insurance products. As a consequence and in order to guarantee a level playing field, the IDD extends the product oversight and governance arrangements which apply for insurance undertakings manufacturing insurance products to insurance intermediaries which pursue such activities as well. Likewise, insurance undertakings do not have to meet the obligations applicable for manufacturers laid down in Article 25 (1) (1) – (5) of the IDD for insurance products which the insurance undertakings do not manufacture, but distribute, only. In this case, the insurance undertakings are only subject to Article 25(1)(6) of the IDD introducing specific product distribution arrangements for distributors of insurance products.
24. EIOPA considers it important to provide further guidance under which circumstances the activities of an insurance distributor should be considered as manufacturing and further specifies what "manufacturing" means. Therefore, EIOPA considers it important to outline and specify under which conditions and based upon which criteria, an insurance intermediary can be considered as acting as a manufacturer. The following explanatory notes on the characteristics of acting as manufacturer refer to insurance intermediaries, only. They apply, accordingly, in the case that insurance undertakings manufacture an insurance product without being the sole insurance undertaking – the insurance product might be a 'combined product' that includes coverage of certain risks by different insurance undertakings.
25. Taking into account the principle of proportionality, it is clear that not all kinds of involvement or influence of an insurance intermediary in the design and manufacturing of an insurance product should be considered as manufacturing.
26. Generally speaking, it can be expected that large brokers, such as managing general agents, could more easily fall under the definition of "manufacturer" in comparison with tied agents – especially those who distribute products on behalf of a sole company. However, it is important to note that the IDD makes no distinction between brokers and tied agents, adopting purely an activity-based definition of an "insurance intermediary".
27. Taking into account the characteristics of the insurance distribution and the specific role of insurance undertakings, it should be assumed that an intermediary can be

considered a manufacturer only when it has a decision-making role in the design and development of insurance products.

28. This depends on the specific circumstances of the individual case and an overall analysis of the respective activities that the insurance intermediary performs with regard to a specific product.

29. In particular, EIOPA considers that the following activities, taken on their own, cannot be considered adequate in order to qualify an intermediary as a manufacturer:

- The mere call for tender for insurance undertakings to cover specific risks required by the insurance intermediary is not relevant when the insurance intermediary does not play any further role in the design of the product;
- The mere possibility to discount the commission or fee paid to the insurance intermediary;
- The activity of handling customer claims;
- The personalisation and adaptation of existing insurance products in the course of insurance distribution activities to the individual customer, in particular cases such as the mere opportunity to choose between different lines of products, contractual clauses and options, recommendation of asset, with regard to a product already designed by the insurance undertaking;
- Tailor-made contracts which are designed at the request of a customer to meet the individual demands and needs of that customer;
- Providing feedback and exchanging information on the distribution of insurance products between manufacturer and distributor.

30. On the other hand, EIOPA is of the view that a decision-making role of the insurance intermediary can be exercised through one of the following practices:

- (i) Design of a new product: the following situations can be included in the notion of "design" if the insurance intermediary has a decision-making role:
 - a) The insurance intermediary takes the initiative to design and define the main elements of a specific insurance product;
 - b) The insurance intermediary defines a certain kind of coverage not already existing in the market for a particular type of customer and asks the undertaking to provide it; or
 - c) The undertaking provides the coverage and establishes the premium under the mandate of the insurance intermediary.
- (ii) A change of significant elements of an existing product: this condition occurs when the coverage, premium, costs, risks, target market or benefits of a type of contract are modified by the insurance intermediary. In all these cases, as the undertaking still provides the coverage, any change should be made under the mandate/authorization of the undertaking and subject to its approval.

31. A decision-making role shall be assumed, in particular, where the insurance intermediary autonomously determines the essential features and main elements of an insurance product, including the coverage, costs, risks, target market or compensation and guarantee rights of the insurance product, which are not substantially modified by the insurance undertaking assuming the underwriting risks. A typical example where a decision-making role by the insurance

intermediary can be assumed are cases where an insurance broker with a high specialisation in a segment of the insurance market, designs a sophisticated insurance product for a market niche based upon his experience and expertise in the specific market (white labelling).

32. **It should be highlighted that the presence of one of these activities may not be sufficient to qualify the insurance intermediary as a manufacturer, but this conclusion should be based upon an overall analysis of the specific activity of the intermediary which should be carried out by the intermediary on a case-by-case basis for each product designed.**
33. A relevant criterion which should be taken into consideration is further the question whether the product is sold under the brand name of the insurance intermediary and whether the insurance intermediary owns the intellectual property rights in the brand name of the product, and whether the intermediary's remuneration depends on the overall performance of the product, profit sharing arrangements, for example.
34. However, it should be noted that, even in cases where an insurance intermediary is considered as acting as a manufacturer, the insurance undertaking providing the coverage (i.e. insurance provider), remains fully responsible to the customer for the contractual obligations resulting from the insurance product, while each co-manufacturer independently remains responsible to comply with the product oversight and governance arrangements of a manufacturer as laid down in Article 25, IDD.
35. Therefore, the insurance undertaking providing the coverage should always be considered a co-manufacturer for the purposes of the application of POG requirements, its role and contractual responsibilities with regard to the customer and its role in the approval process of the insurance product.
36. Co-manufacturing partnerships should necessarily be established in a written agreement, so that competent authorities are in a position to supervise collaboration arrangements.
37. In this case, through a necessary and proportionate collaboration between the two manufacturers (the insurance undertaking and the insurance intermediary/*de facto* manufacturer), all the arrangements and forms of collaboration necessary should be put in practice in order to comply with the product governance requirements for each product co-designed.
38. Whereas the collaboration agreement sets out how the co-manufacturer have bilaterally agreed upon their respective tasks, it cannot limit the respective civil law responsibilities towards the customer or the respective regulatory responsibilities of the parties towards the competent authorities.
39. As far as insurance undertakings are manufacturers and at the same time distributors of their own insurance products, they have to fulfil with the product oversight and governance arrangements for manufacturers of insurance products, only. Insurance undertakings only have to fulfil the product distribution arrangements where they distribute insurance products they do not manufacture.

Target Market

40. The manufacturer shall identify the group of customers for whom the insurance product is compatible (target market) and only design and bring to the market products with features which are aligned with the demands and needs of the target market the manufacturer has identified.

41. When assessing whether a product is compatible for a group of customers the manufacturer should take into account criteria such as the demands and needs, and, where relevant with regard to the complexity and nature of the product, the knowledge and experience in the investment field, financial situation, the investment objectives and the financial literacy of the typical customer of the target market.
42. EIOPA considers it important to take account of the principle of proportionality when considering the granularity of the target market. Insurance products are quite heterogeneous and their complexity varies. Some insurance products are obligatory for consumers and product choice would be limited. This is, for example, the case with motor insurance products. Some insurance products are complex such as many insurance-based investment products (IBIPs). All products differ and, therefore, the granularity of the target markets can differ depending on the complexity and nature of the product and the risk of consumer detriment. There may be product limitations which are simple to understand, but would mean that the target market assessment would need to be more granular in detail.
43. Even with compulsory motor insurance products, for example, not all customers would need 'fully comprehensive' coverage meaning that a 'fully comprehensive' product may not be compatible for all customers. Therefore, specification of the target market should be more meaningful than simply describing it as 'mass market' suitable for any type of insurance product.
44. This approach is in line with the principles underlying the individual customer assessments in IDD, such as the "demands and needs" test and the suitability and appropriateness tests. The criteria used in these tests are generally relevant to define the target market since the target market is an abstract description of the characteristics of a group of consumers, whereas the individual assessments as laid down in the IDD, verify whether the insurance product fits with the specificities of the individual customer.
45. Examples of criteria which could be considered to determine the target market are detailed below. It should be noted that the examples are not exhaustive and non-binding. If necessary, manufacturers should add additional categories based on the specific product and risk profile.
46. The criteria differ depending on the type of insurance product and the insurance coverage provided. Not all criteria which are relevant for one type of insurance product might be relevant for another type of insurance product as well. The level of detail will depend on the complexity of the product and some criteria may not be appropriate for less complex products.
47. Examples for all insurance products:
 - the level of the target market's knowledge and understanding of the complexity of the product,
 - the objectives, demands and needs of the customers belonging to the target market.
48. Examples, in particular, for IBIPs:
 - the age of the customers belonging to target market;
 - the occupational situation of the customers belonging the target market;
 - the level of risk tolerance of the customers belonging the target market;
 - the financial situation of the customers belonging the target market;

- the financial and non-financial objectives and investment horizon of the customers belonging to the target market.

49. Examples, in particular, for health insurance:

- The occupational situation of the customers belonging to the target market;
- The social security coverage of the customers belonging to the target market;

50. Examples for other insurance products:

- Risks, coverage, needs etc.

51. The level of knowledge and understanding of the product could also include experience of targeted consumers with similar products. The customer's financial situation could, for example, be relevant for the sale of Payment Protection Insurance (PPI). Here, it could be considered whether the product is suitable for consumers with a temporary employment contract or if it is only suitable for consumers with a fixed contract.

52. The policy proposal makes clear that identifying for whom the product may be suitable, is helpful in order to obtain a clear picture of cases where it may be rather questionable for whom the product would not be suitable (e.g. a life insurance policy running for 30 years for a 97-year-old person).

53. If an insurance product is not compatible with the demands and needs, characteristics as well as investment objectives of a specific group of customers, the manufacturer shall also identify the target market to which the insurance product should not be distributed, if relevant from a consumer protection perspective and, in particular, for insurance-based investment products.

54. The level of granularity cannot uniformly be defined for all products as in the insurance market there is a wide range of products which differ in characteristics and complexity. The features listed above may not be appropriate for all insurance products and should be applied using a risk-based approach.

Skills, knowledge and expertise involved in designing products

55. According to the general principle of good governance stated in Article 258(1)(e) of Commission Delegated Regulation (EU) No 2015/35 under Solvency II, insurance undertakings are required to "*employ personnel with the skills, knowledge and expertise necessary to carry out the responsibilities allocated to them properly*". In that respect, the manufacturer should ensure that relevant personnel involved in designing products should possess the necessary skills, knowledge and expertise in order to properly understand the product's main features and characteristics as well as the interests, objectives and characteristics of the target market.

56. As necessary, the staff involved in designing products should receive, for instance, appropriate professional training to understand the characteristics and risks of the relevant products and the interests, objectives and characteristics of the target market.

Product Testing

57. Before a product is brought to the market, or if the target market is changed or changes to an existing product are introduced, the manufacturer should conduct appropriate testing of the product including, if relevant and, in particular, for insurance-based investment products, scenario analyses in order to align the product with the interests of the target market. The range of scenario analysis

needs to be proportionate to the complexity of the product, its risks and the relevance of external factors with respect to the product performance.

58. Keeping in mind the objectives of the defined target market, the assessment could imply considering the following questions:

- What if assumptions change, for instance if market conditions deteriorate?
- Is the price of the policy in balance with the worth of the underlying? For instance, is it possible to conclude an all-risk policy for an old car?
- What if certain circumstances during the lifetime of the product change? For instance, what happens with the premium of a Payment Protection Insurance (PPI) policy if a person becomes unemployed, disabled or experiences other life events? What are the consequences for the coverage of a PPI product when a married couple divorces?
- What happens to the (guaranteed) coverage (insured amounts) of a fire and theft insurance when the income changes?

59. In addition to the question above, more specifically for insurance-based investment products, the assessment could imply considering also the following questions:

- What would happen to the risk and reward profile of the product following changes to the value and liquidity of underlying assets?
- How is the risk/reward profile of the product balanced, taking into account the cost structure of the product?
- When a product benefits from a certain tax environment or other condition; what happens if these conditions change?
- What are the terms and conditions, and how do they affect the outcome of the product?
- What will happen when the manufacturer faces financial difficulties?
- What will happen if the customer terminates the contract early?

60. In addition to the questions above, more specifically for pure protection life insurance products, the assessment could imply considering also the following questions:

- What if the premises change, for instance, the mortality rate or the technical interest rate increases?
- Does the benefit cover sufficiently future needs of beneficiary?

61. In the case of non-life insurance, the assessment could imply considering the following questions:

- What is the expected claims ratio and the claims payment policy? What if it is higher or lower than expected? Do the expected claims ratio and claims payment policy suggest that the product is of benefit to customers?
- Does the coverage of one product potentially overlap with the coverage of another product?
- Does the coverage meets sufficiently future needs of target market? How is the coverage updated in terms of reflecting future needs of target market?
- Do customers understand the terms and limitations of the contract?

- Would the manufacturer be able to cope with a large amount of customers? Is the amount of staff sufficient enough to deal with a large amount of requests from customers?

62. EIOPA believes that especially the claim ratio is an important criterion to assess whether an insurance product is of added value for consumers, but agrees that other indicators may be considered for the sake of a comprehensive assessment. EIOPA does not pursue the intention to introduce a general price control.

63. On the basis of the PRIIPs Regulation¹⁹, EIOPA considers that the manufacturer of an insurance-based investment product will be required to produce a Key Information Document (KID) containing information on the risk and reward profile of the product. Performance scenarios expected to be presented in the KID and the range of scenarios used for testing the product may present similarities; however, may not necessarily be identical. Performance scenarios are disclosed to customers whereas scenarios for testing the products cover a large range of factors that determine the performance of the product.

Product monitoring and review

64. The manufacturer should continuously monitor and regularly review the product to identify crucial events that could materially affect the main features, the risk coverage and the guarantees of the products, e.g. the potential risk or return expectations. When reviewing existing products, the manufacturer should further consider if the product remains aligned with the demands and needs, and where relevant, with regard to the complexity of the product, the knowledge and experience in the investment field as well as the financial situation and investment objectives of the typical customer of the target market.

65. The IDD requires insurance undertakings to regularly review the insurance products they offer or market. The issue of the frequency of the review was discussed in the impact assessment of the EIOPA Preparatory Guidelines and more specifically, whether the frequency of the review should be determined. The pros and cons of both options were discussed and EIOPA concluded that, given the wide range of products offered as well as the differences between the firms selling the products, that the frequency of the reviews should not be uniformly determined.

66. Instead, the decision with regards to the frequency of the review, should be left to the manufacturer (and the distributor, where appropriate). In doing so, the manufacturer should take into consideration the product specificities. This option allows each manufacturer to adapt the correct frequency of the review process in line with the timing of the internal design product, also taking into account the size, scale and complexity of the insurance undertaking and of the different products it manufactures.

67. It is important that the manufacturer and the distributor coordinate their reviews and should aim to have similar frequencies of reviews. Manufacturers should consider: i) what information they need to review a product and ii) what information they already hold. If they need additional information from distributors, they can choose how to gather that information and from which distributors.

¹⁹ Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs)

68. However, EIOPA considers that the delegated acts should specify that the manufacturer should decide how regularly their products should be reviewed: This should be based on relevant factors such as the nature of the product and the target market or if they become aware of any event that could materially affect the potential risk to investors.

Remedial action

69. EIOPA considers manufacturers and distributors should take appropriate action when they become aware of an event that could materially affect the potential guarantees to the identified target market. However, given the wide range of products offered as well as the differences between the undertakings selling the products, EIOPA considers that there should be no specific action to be taken in all cases and that flexibility should be given to manufacturers and distributors to decide what steps they need to take, based on the circumstances of the case.

70. Nevertheless, manufacturers and distributors should make their best effort to identify events that would materially affect the potential expectations regarding product guarantees and, when such an event occurs, they should take appropriate action on a case-by-case basis. These actions could be the following (the list is not exhaustive):

- the provision of any relevant information on the event and its consequences on the product to the customer, or the distributors of the product if the firm does not offer directly the product to the customer;
- changing the product approval process;
- changing the product;
- proposing a new product to the customer;
- changing the target market;
- stopping further issuance of the product;
- contacting the distributor to discuss a modification of the distribution process;
- terminating the relationship with the distributor;
- informing the relevant competent authority; or
- informing the customer.

71. Furthermore, the manufacturer needs to take appropriate action whenever he becomes aware that the product might cause detriment to customers. This might be the case during the regular product monitoring exercise or the product review, but also when he is, for instance, informed by the insurance distributor or through a complaint.

72. The product lifetime is understood as capturing the entire life cycle of a product which begins at the moment when the product is being designed and only finishes once there is no product left on the market. It covers situations when the product is no longer being sold, but there are still customers who own the product. The end of the life cycle of the product is reached only when the last product has been withdrawn from the market.

73. For example, remedial action needs to be taken when the product no longer meets the general needs of the target market or when the product performance is significantly different from what the manufacturer originally expected.

74. As a general principle, and, in accordance with national legal framework, the manufacturer can only make changes to the product that are consistent with the interests, objectives and characteristics of the already existing target market and these changes do not have an adverse impact on the customer to which the product has been sold already.
75. In order to prevent customer detriment efficiently, it might also be necessary that the manufacturer notifies the remedial action taken to the insurance intermediary involved and to the customer in case of direct sales. This might be the case where the risk profile of a product has changed due to market developments and the product is no longer in line with the interests, objectives and characteristics of the target market.

Distribution channels

76. The manufacturer needs to select insurance distributors that have the necessary knowledge, expertise and competence to understand the product features and the characteristics of the identified target market, correctly place the product in the market and give the appropriate information to customers.
77. If the manufacturer identifies problems with the selected distribution channels (i.e. when the insurance distributor is offering the product to customers for whom it is not compatible) they need to take appropriate action. In the case of independent insurance intermediaries, manufacturers might, for instance, need to consider ceasing making available the relevant products to the insurance intermediary not meeting the product oversight and governance objectives of the manufacturer.
78. Article 25(1)(3) IDD requires manufacturers to take reasonable steps to ensure that the insurance product is distributed to the identified target market. In order to achieve this goal, it is important that the manufacturer monitors and examines on a regular basis whether the product is distributed to customers belonging to the relevant target market in order to assess whether the steps taken are appropriate and efficient.
79. However, it should be emphasised that the monitoring obligation is limited to the assessment whether the distribution channels carry out their distribution activities in accordance with the product oversight and governance arrangements established by the manufacturer, in particular whether insurance products are distributed to the target market identified by the manufacturer. The monitoring obligation does not extend to the general regulatory requirements which distributors have to fulfil when carrying out insurance distribution activities for the individual customers (in particular, the conduct of business rules as laid down in IDD). The monitoring activities should be reasonable taking into consideration the specificities and nature of the respective distribution channels.

Information to be provided to the distributors

80. The IDD rules on POG arrangements aim to strengthen the exchange of product-related information between the manufacturer and distributor.
81. According to Article 25(1)(5), IDD, insurance undertakings, as well as insurance intermediaries which manufacture insurance products, shall make available to distributors all appropriate information on the insurance product and the product approval process, including the identified target market of the insurance product.
82. Vice-versa, according to Article 25(1)(6), IDD, where the insurance distributor advises on or proposes insurance products which it does not manufacture, it shall

have in place adequate arrangements to obtain the information (referred to above) and to understand the characteristics and identified target market of each insurance product.

83. The purpose of these requirements is to ensure that the distributor receives all necessary information on the product and the product approval process from the manufacturer which is considered as an important prerequisite in order to carry out the insurance distribution activities in accordance with the best interests of their customers.
84. The purpose of the requested exchange of information between manufacturers and distributors is laid down in Recital 55, IDD, stating that the distributor should *"in any case be able to understand the characteristics and identified target market of each insurance product"*.
85. The importance of having appropriate knowledge and competence is furthermore emphasised in the general rule of Article 10, IDD requiring insurance distributors and their employees carrying out insurance distribution activities, to possess appropriate knowledge and ability in order to complete their tasks and perform their duties adequately.
86. However, the obligation of the manufacturer to make available "all appropriate information" and the obligation of the distributor to obtain that information as laid down in Article 25 of IDD is generally abstract and high-level.
87. Besides the identified target market, the IDD neither specifies the information which the manufacturer is required to make available to the distributor nor specifies the consequences if the distributor does not receive all necessary information. In view of the importance of this matter, EIOPA considers it important to further specify the information, which the distributor should obtain in order to be in a position to distribute the insurance products to its customers further.
88. In view of the variety of insurance products and product features, EIOPA does not consider it appropriate to propose an exhaustive list of information which the distributor should obtain. Instead, EIOPA proposes to introduce a high-level principle combined with specific information details, which should be understood as the bare minimum (see policy proposal below).
89. Taking into consideration the principle of proportionality, the level of information details should take into account the complexity and comprehensibility of the products, the risks of the product and the services provided with regard to the respective products (advice, non-advised sale, execution-only).
90. With regard to the consequences in cases where the distributor fails to obtain all relevant information on the product from the manufacturer or from public sources, EIOPA notes that the legal text of the IDD does not specify what the consequence should be. From a customer protection point of view, however, EIOPA would consider it important that the distributor is pre-emptively prevented from recommending insurance products in order to avoid any detriment to customers' interests from the outset. This would be complementary to the empowerment of competent authorities to impose (ex post) sanctions for infringing the conduct of business requirements set out in Chapter VII of IDD.

Documentation of product oversight and governance arrangements

91. EIOPA considers it important that insurance intermediaries and insurance undertakings keep appropriate records about all relevant action taken in relation to the product oversight and governance arrangements and make available those

records to the competent authorities upon request if needed for supervisory purposes.

b. Analysis for arrangements applicable to insurance distributors

92. The arrangements apply to all insurance undertakings, insurance intermediaries and ancillary insurance intermediaries advising or proposing insurance products, which they do not manufacture.

Establishment and objectives of distribution arrangements

93. EIOPA considers that insurance distributors need to establish appropriate measures and procedures with regard to the insurance products they intend to distribute. Contrary to manufacturer's arrangements, insurance distributors are not required to design and subsequently to review the products, but to take the necessary steps in preparation of the distribution of insurance products to the customer (such as obtaining all relevant information from the manufacturer and defining a distribution strategy).

94. The distribution arrangements should aim to prevent, or, if not, mitigate, customer detriment, support a proper management of conflicts of interests and should ensure that the customer's demands and needs, and, if relevant, their knowledge and experience in the investment field, their financial situation and investment objectives are duly taken into account.

95. According to this approach, insurance distributors need to consider to which extent the product choice gives rise to the risk of conflicts of interest and if so, which measures should be taken in order to ensure that the distribution activities are carried out in accordance with the best interests of the customer. This might also imply that distributors abstain from distributing specific insurance products, for example, in cases where products do not offer any value to the customer, but only a high commission to the distributor.

Role of Management

96. EIOPA emphasises that the ultimate responsibility with regard to the product distribution arrangements lies with the insurance distributor's administrative, management or supervisory body or equivalent structure even though it is possible that the tasks are delegated either internally or even externally (e.g. in cases of outsourcing). In particular, the ultimate responsibility for the organisational measures and procedures lies with the management of the distributor which is registered and responsible for the distribution activities. For sole traders, it is evident that they bear the responsibility for their entire business.

Obtaining all relevant information on the insurance product from the manufacturer

97. An important prerequisite to setting up a distribution strategy is that the insurance distributor has appropriate knowledge about the approval process of the manufacturer, in particular the target market of the individual insurance product, as well as about all other necessary information on the product from the manufacturer in order to fulfil its regulatory obligations towards the customer. This information helps the insurance distributor to select the insurance products the

insurance distributor intends to distribute and to assess to which customers the insurance distributor may advertise and promote the individual insurance products.

98. According to this approach, the insurance distributor should establish appropriate arrangements to obtain from the manufacturer all relevant information on the product which is necessary to carry out its distribution activities.

Distribution strategy

99. Where the insurance distributor sets up or follows its own distribution strategy, this strategy needs to be consistent with the target market identified by the manufacturer of the respective insurance product. In particular, this means that the distribution strategy should not foresee insurance products being distributed to customers which are not part of the target market identified by the manufacturer. The distribution strategy may also outline circumstances under which the distribution of insurance products to customers outside of the target market is permitted exceptionally.

100. The target market identified by the manufacturer specifies the group of customers to whom the insurance products should generally be distributed. On an exceptional basis, the insurance distributor may distribute insurance products to a customer, who does not belong to the identified target market, provided that the insurance distributor can prove that the respective insurance product meets the demands and needs of the individual customer, and, in the case of insurance-based investment products, is appropriate or suitable for the customer.

Informing the manufacturer

101. For the sake of customer protection, EIOPA considers it crucial to enhance the exchange of information between manufacturer and insurance distributor to facilitate market monitoring by the manufacturer. This does not mean that the insurance distributor needs to report every sale to the manufacturer or that the manufacturer needs to confirm that every transaction was made with respect to the correct target market, but the insurance distributor should communicate the relevant information such as the amount of sales made outside the target market, summary information on the customer or a summary of the complaints received with regard to a specific product.

Documentation of distribution arrangements

102. EIOPA considers it important that insurance distributors keep appropriate records about all relevant action taken in relation to the product oversight and governance arrangements and make available those records to the competent authorities upon request, if needed for supervisory purposes.

1. Policy proposals for insurance undertakings and insurance intermediaries which manufacture insurance products for sale to customers

Establishment of product oversight and governance arrangements

1. Insurance undertakings and insurance intermediaries which manufacture any insurance product for sale to customers (the "manufacturer") shall maintain, operate and review product oversight and governance arrangements that set out appropriate measures and procedures aimed at designing, monitoring, reviewing and distributing products for customers, as well as taking action in respect of products that may lead to detriment to customers (product oversight and governance arrangements).
2. The product oversight and governance arrangements need to be proportionate to the level of complexity and the risks related to the products as well as the nature, scale and complexity of the relevant business of the manufacturer.
3. The manufacturer shall set out the product oversight and governance arrangements in a written document ("product oversight and governance policy") and make it available to its relevant staff.

Objectives of the product oversight and governance arrangements

4. The product oversight and governance arrangements shall aim to prevent or mitigate customer detriment, support a proper management of conflicts of interests and shall ensure that the customer's demands and needs, and, if relevant, their knowledge and experience in the investment field, their financial situation and investment objectives are duly taken into account.

Role of management

5. The manufacturer's administrative, management or supervisory body or equivalent structure responsible for the manufacturing of insurance products shall endorse, and be ultimately responsible for, the establishment, implementation, subsequent reviews and continued internal compliance with the product oversight and governance arrangements.

Acting as manufacturer

6. Based upon an overall analysis of the specific activity of the insurance intermediary, an insurance intermediary shall be considered as a manufacturer if the insurance intermediary has a decision-making role in designing and developing an insurance product for the market. This shall accordingly apply for insurance undertakings which do not provide coverage for an insurance product, but have a decision-making role in designing and developing this insurance product.
7. A decision-making role shall be assumed, in particular, where the insurance distributor autonomously determines the essential features and main elements of an insurance product, including the coverage, costs, risks, target market,

compensation and guarantee rights of the insurance product, which are not substantially modified by the insurance undertaking assuming the underwriting risks. A decision-making role shall be assumed, for example, in instances where an insurance distributor designs a sophisticated insurance product for a market niche based upon his experience and expertise of the specific market.

8. Activities which relate to the personalisation and adaptation of existing insurance products in the course of insurance distribution activities to the individual customer, as well as the design of tailor-made contracts at the request of one customer shall not be considered as activities of manufacturing, in particular cases such as the mere opportunity to choose between different lines of products, contractual clauses and options, individual premium discounts, recommendation of asset, with regard to a product already designed by the insurance undertaking, or the exchange of information between manufacturer and distributor related to these products.
9. Where an insurance intermediary or insurance undertaking is considered as a manufacturer according to paragraph 6, it shall define in a written agreement with the insurance undertaking issuing the insurance product, their collaboration and their respective roles, in particular, clarifying the procedures through which the two parties agree on the identification of the target market. The insurance undertaking issuing the insurance product remains fully responsible to the customer for the coverage provided, while both independently remain responsible for complying with the product oversight and governance arrangements of a manufacturer, as laid down in Article 25, IDD.

Review of product oversight and governance arrangements

10. The manufacturer shall regularly review the product oversight and governance arrangements to ensure that they are still valid and up to date and the manufacturer shall amend them, where appropriate.

Target market

11. The manufacturer shall identify the target market for each insurance product and specify the group of customers for whom the insurance product is compatible. As the identification of the target market describes a group of customers sharing common characteristics at an abstract and generalised level, it has to be distinguished from the individual assessment whether an insurance product is consistent with the demands and needs, and where applicable whether the insurance product is suitable and appropriate for the individual customer at the point of sale.
12. For the assessment whether an insurance product is compatible for a group of customers, the manufacturer shall only design and bring to the market products with features which are aligned with the demands and needs of the target market, and, where relevant with regard to the complexity and nature of the product, the knowledge and experience in the investment field as well as financial situation, including the ability to bear losses, and investment objectives of a typical customer of the target market.

13. When deciding whether a product is compatible with a target market, the manufacturer shall consider the level of information available to the target market and the financial literacy of the target market.
14. The target market shall be identified at a sufficiently granular level, depending on the characteristics, risk profile, complexity and nature of the product, avoiding groups of customers for whose demands and needs, and, where relevant, knowledge and experience in the investment field as well as financial situation and investment objectives, the product is generally not compatible.
15. Where relevant from a consumer protection perspective, the manufacturer shall also identify groups of customers for whom the product is generally not compatible.

Skills, knowledge and expertise of personnel involved in designing products

16. The manufacturer shall ensure that relevant personnel involved in designing products possess the necessary skills, knowledge and expertise in order to properly understand the product's main features and characteristics as well as the interests, objectives and characteristics of the target market.

Product testing

17. Before a product is brought to the market, or if the target market is changed, or changes to an existing product are introduced, the manufacturer shall conduct appropriate testing of the product including, if relevant, scenario analyses. The product testing shall assess if the product is in line with the objectives for the target market over the lifetime of the product.
18. The manufacturer shall not bring a product to the market if the results of the product testing show that the product is not aligned with the interests, objectives and characteristics of the target market.
19. The manufacturer shall carry out product testing in a qualitative and, where appropriate, in a quantifiable manner depending on the type and nature of the product and the related risk of detriment to customer.

Product monitoring and review

20. Once the product is distributed, the manufacturer shall continuously monitor and regularly review the product to identify crucial events that could materially affect the main features, the risk coverage and the guarantees of the products, e.g. the potential risk or return expectations.
21. When reviewing existing products, the manufacturer shall further consider if the product remains aligned with the demands and needs, and where relevant, with regard to the complexity of the product, the knowledge and experience in the investment field as well as the financial situation and investment objectives of the typical customer of the target market. The manufacturer shall also consider if the product is being distributed to the target market, or is reaching customers outside of the target market.

22. The manufacturer should determine the frequency for the regular review, taking into account the size, scale, contractual duration and complexity of the respective insurance product.

Remedial action

23. Should the manufacturer identify, during the lifetime of a product, circumstances which are related to the product and give rise to the risk of customer detriment, the manufacturer shall take appropriate action to mitigate the situation and prevent the re-occurrence of detriment.
24. If relevant, the manufacturer shall notify any relevant remedial action promptly to the distributors involved and to customers.

Distribution channels

25. The manufacturer shall select distribution channels that are appropriate for the target market considering the particular characteristics of the product.
26. The manufacturer shall select distributors with appropriate care.
27. The manufacturer shall provide to the insurance distributors all relevant information on the insurance product, the product approval process, the target market and distribution strategy.

This includes information on the main characteristics of the insurance product, its risks and costs (including implicit costs), as well as circumstances which may cause a conflict of interest to the detriment of the customer. The information shall be of an adequate standard, which is clear, precise and up-to-date.

28. The information given to distributors shall be sufficient to enable them to:
 - understand and place the product properly on the target market;
 - identify the target market for which the product is designed and also to identify the group of customers for whom the product is considered likely not to meet their interests, objectives and characteristics; and
 - to carry out insurance distribution activities in accordance with the best interests of its customers in accordance with Article 17(1) of Directive (EU) 2016/97.
29. The manufacturer shall take all reasonable steps to monitor that distribution channels act in compliance with the objectives of the manufacturer's product oversight and governance arrangements.
30. The manufacturer shall examine, on a regular basis, whether the product is distributed to customers belonging to the relevant target market.
31. When the manufacturer considers that the distribution channel does not meet the objectives of the manufacturer's product oversight and governance arrangements, the manufacturer shall take appropriate remedial action towards the distribution channel.

Outsourcing of the product design

32. The manufacturer shall retain full responsibility for compliance with product oversight and governance arrangements as described in this Technical Advice when it designates a third party to design products on their behalf.

Documentation of product oversight and governance arrangements

33. Relevant actions taken by the manufacturer in relation to the product oversight and governance arrangements shall be duly documented, kept for audit purposes and made available to the competent authorities upon request.

2. Policy proposals for insurance distributors which advise on or propose insurance products which they do not manufacture

Establishment of product distribution arrangements

34. The insurance distributor shall establish and implement product distribution arrangements that set out appropriate measures and procedures for considering the range of products and services the insurance distributor intends to offer to its customers, for reviewing the product distribution arrangements and for obtaining all necessary information on the product(s) from the manufacturer(s).
35. The product distribution arrangements need to be proportionate to the level of complexity and the risks related to the products as well as the nature, scale and complexity of the relevant business of the insurance distributor.
36. The insurance distributor shall set out the product distribution arrangements in a written document and make it available to its relevant staff.

Objectives of the product distribution arrangements

37. The product distribution arrangements shall aim to prevent or mitigate customer detriment, support a proper management of conflicts of interests and shall ensure that the customer's demands and needs, and, if relevant, their knowledge and experience in the investment field, their financial situation and investment objectives are duly taken into account.

Role of management

38. The insurance distributor's administrative, management or supervisory body or equivalent structure responsible for the insurance distribution, shall endorse and be ultimately responsible for the establishment, implementation, subsequent reviews and continued internal compliance with the product distribution arrangements.

Obtaining all relevant information on the insurance product from the manufacturer

39. The product distribution arrangements shall aim to ensure that the insurance distributor obtains all relevant information which have to be provided, as referred to in paragraph 27, from the manufacturer on the insurance product, the product approval process, the target market and the distribution strategy. This includes information on the main characteristics of the insurance product, its risks and costs (including implicit costs), as well as circumstances which may cause a conflict of interest to the detriment of the customer.
40. The information shall enable the distributors to:
 - understand and place the product properly on the target market;
 - identify the target market for which the product is designed and also to identify the group of customers for whom the product is considered likely not to meet their interests, objectives and characteristics; and

- to carry out insurance distribution activities in accordance with the best interests of the customer in accordance with Article 17(1) of Directive (EU) 2016/97.

Distribution strategy

41. Where the insurance distributor sets up or follows a distribution strategy, it shall not contradict the distribution strategy and the target market identified by the manufacturer of the insurance product.

Regular review of product distribution arrangements

42. The insurance distributor shall regularly review the product distribution arrangements to ensure that they are still valid and up to date and shall amend them where appropriate, in particular the distribution strategy, if any.
43. If the distributor has independently set up a distribution strategy, he shall amend the distribution strategy in view of the outcome of the review, where appropriate.
44. When reviewing distribution arrangements, the distributor shall consider if the product is being distributed to the identified target market, or is reaching customers outside the target market.
45. The distributor shall determine how regularly to review the product distribution arrangements based on relevant factors and taking into account the size, scale and complexity of the different products involved.
46. Upon request, distributors shall provide the manufacturer with relevant sales information and, if necessary, information on the above reviews to support product reviews carried out by manufacturers.

Informing the manufacturer

47. If the insurance distributor becomes aware of any problems causing the risk of customer detriment regarding the target market for a specific product or service, or that a given product or service no longer meets the criteria of the identified target market, he shall promptly inform the manufacturer and, as appropriate, update the distribution strategy already put in place.

Documentation

48. Relevant actions taken by the insurance distributor in relation to the product distribution arrangements shall be duly documented, kept for audit purposes and made available to the competent authorities on request.

4. Conflicts of Interest

Background/mandate

Extract from the Commission's request for advice (mandate)

"EIOPA is invited to provide technical advice on:

- the different steps that insurance intermediaries and insurance undertakings distributing insurance-based investment products might reasonably be expected to take within an effective organisational and administrative arrangement designed to identify, prevent, manage and disclose conflicts of interest;*
- the circumstances and situations to take into account when determining which types of conflict of interest may damage the interests of the customers or potential customers of an insurance intermediary or insurance undertaking.*

The technical advice should specify the different steps to be taken within an effective organisational and administrative arrangement designed to identify, prevent, manage and disclose conflicts of interest. This should include, in particular, the requirements for periodical review of conflicts of interest policies and clarifications with respect to the last resort nature of disclosure which should not be over-relied on by insurance intermediaries and insurance undertakings nor used as a measure to manage conflicts of interest. Particular attention should be given to the practical implementation of the proportionality requirement.

In order to ensure regulatory consistency, the technical advice should build on existing conflict of interest rules, as laid down in Commission Directive 2006/73/EC, particularly with regard to establishing appropriate criteria for determining the types of conflict of interest whose existence may damage the interests of customers or potential customers. It should also be consistent with the line taken in the delegated acts expected to be adopted under Article 23(4) of MiFID II."

1. The relevant provisions in the Insurance Distribution Directive are:

Recital 39:

"The expanding range of activities that many insurance intermediaries and undertakings carry on simultaneously has increased potential for conflicts of interest between those different activities and the interests of their customers. It is therefore necessary to provide for rules to ensure that such conflicts of interest do not adversely affect the interests of the customer".

Recital 57:

"In order to ensure that any fee or commission or any non-monetary benefit in connection with the distribution of an insurance-based investment product paid to or paid by any party, except the customer or a person on behalf of the customer, does not have a detrimental impact on the quality of the relevant service to the customer, the insurance distributor should put in place appropriate and proportionate arrangements in order to avoid such detrimental impact. To that end, the insurance

distributor should develop, adopt and regularly review policies and procedures relating to conflicts of interest with the aim of avoiding any detrimental impact on the quality of the relevant service to the customer and of ensuring that the customer is adequately informed about fees, commissions or benefits”.

Article 27:

“Without prejudice to Article 17, an insurance intermediary or an insurance undertaking carrying on the distribution of insurance-based investment products shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest as determined under Article 28 from adversely affecting the interests of its customers. Those arrangements shall be proportionate to the activities performed, the insurance products sold and the type of the distributor.”

Article 28:

1. *“Member States shall ensure that insurance intermediaries and insurance undertakings take all appropriate steps to identify conflicts of interest between themselves, including their managers and employees, or any person directly or indirectly linked to them by control, and their customers or between one customer and another, that arise in the course of carrying out any insurance distribution activities.*
2. *Where organisational or administrative arrangements made by the insurance intermediary or insurance undertaking in accordance with Article 27 to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to customer interests will be prevented, the insurance intermediary or insurance undertaking shall clearly disclose to the customer the general nature or sources of the conflicts of interest, in good time before the conclusion of an insurance contract.*
3. *By way of derogation from Article 23(1), the disclosure referred to in paragraph 2 of this Article shall:*
 - (a) *be made on a durable medium; and*
 - (b) *include sufficient detail, taking into account the nature of the customer, to enable that customer to take an informed decision with respect to the insurance distribution activities in the context of which the conflict arises.*
4. *The Commission shall be empowered to adopt delegated acts in accordance with Article 38 in order to:*
 - (a) *define the steps that insurance intermediaries and insurance undertakings might reasonably be expected to take to identify, prevent, manage and disclose conflicts of interest when carrying out insurance distribution activities;*
 - (b) *establish appropriate criteria for determining the types of conflict of interest whose existence may damage the interests of the customers or potential customers of the insurance intermediary or insurance undertaking.”*

Analysis

2. EIOPA has been invited by the Commission to provide technical advice on organisational and administrative arrangements designed to identify, prevent, manage and disclose conflicts of interest that arise in the course of carrying out any insurance distribution activities.
3. In its mandate, the Commission explicitly invites EIOPA to build on the results of previous work that has already been carried out by EIOPA, such as EIOPA's previous technical advice on conflicts of interests in direct and intermediated sales of insurance-based investment products.²⁰ The latter was submitted to the Commission on 6 January 2015 and referred to the rules on conflicts of interest which were introduced under Article 91, MiFID II²¹ and were supposed to amend the Insurance Mediation Directive (IMD)²².
4. Taking into consideration that the new requirements on conflicts of interest as outlined in Articles 27 and 28, IDD, are almost identical with the requirements which have been originally introduced under MiFID II, EIOPA considers it appropriate to base its current technical advice on the 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 and for the purpose of alignment with the draft Commission Delegated Regulation under MiFID II regarding organisational requirements and operating conditions for investment firms²³.
5. For this purpose, it has been clarified that **the disclosure of conflict of interest should be understood as 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. Any overreliance on disclosure should be considered a deficiency in the conflicts of interest policy.**
6. Instances where conflicts of interest typically arise and which need to be appropriately managed by the insurance undertakings or insurance intermediary include the following:
 - The insurance undertaking/insurance intermediary has an own interest in selling products of its own group (e.g. 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 insurance-based investment product due to his own portfolio (own-account trading).

²⁰ [https://eiopa.europa.eu/Publications/Opinions/EIOPA-15-135_Technical%20Advice%20%20Impact%20Assessment_conflicts_of_interest_version%20for%20COM%20\(2\).pdf](https://eiopa.europa.eu/Publications/Opinions/EIOPA-15-135_Technical%20Advice%20%20Impact%20Assessment_conflicts_of_interest_version%20for%20COM%20(2).pdf)

²¹ <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0065>

²² <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32002L0092>

²³ <http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2398-EN-F1-1.PDF>

7. EIOPA acknowledges that the management of conflicts of interest, in particular those that arise between customers, should be undertaken in a way which takes into account the basic principles in insurance, in particular the principles of solidarity, risk pooling and mathematical methods.
8. EIOPA also notes that the European legislator has put emphasis on the application of the principle of proportionality in stating in Article 27, IDD, that the *"arrangements shall be proportionate to the activities performed, the insurance products sold and the type of distributor"*. EIOPA would like to point out that the policy proposals which were developed for the IMD explicitly refer to the principle of proportionality in stating that the procedures and measures should be *"appropriate to the size and activities of the insurance intermediaries or insurance undertaking ... and to the materiality of the risk of damage to the interests of the customer"*.
9. The measures and procedures taken by the insurance intermediary or insurance undertaking to identify, prevent and manage conflicts of interest under this section are without prejudice to the specific rules on inducements, in particular the obligation to assess the detrimental impact of inducements on the relevant service to the customer. EIOPA would like to emphasise that the assessment that a specific inducement or inducement scheme has a detrimental impact on the quality of the relevant service cannot be counterbalanced by any kind of organisational measure or procedure taken in accordance with the policy proposals outlined below.

Identification of conflicts of interests

1. For the purpose of identifying the types of conflict of interest that arise in the course of carrying out any insurance distribution activities related to insurance-based investment products and which entail the risk of damage to the interests of a customer, insurance intermediaries and insurance undertakings shall assess whether they, including their managers, employees or any person directly or indirectly linked to them by control, have an interest related to the insurance distribution activities which is distinct from the customer's interest and which has the potential to influence the outcome of the services to the detriment of the customer. Insurance intermediaries and insurance undertakings shall also identify conflicts of interest between one customer and another.
2. For the purpose of identifying conflicts of interest as outlined in paragraph 1, insurance intermediaries and insurance undertakings shall take into account, by way of minimum criteria, any of the following situations:
 - a. the insurance intermediary, insurance undertaking, including their managers, employees, or any person directly or indirectly linked to them by control, is likely to make a financial gain, or avoid a financial loss, to the detriment of the customer;
 - b. the insurance intermediary, insurance undertaking, including their managers, employees, or any person directly or indirectly linked to them by control, has a financial or other incentive to favour the interest of another customer or group of customers over the interests of the customer;
 - c. the insurance intermediary, insurance undertaking, including their managers, employees, or any person directly or indirectly linked to them by control, receives or will receive from a person other than the customer a monetary or non-monetary benefit in relation to the insurance distribution activities provided to the customer;
 - d. the insurance intermediary, persons working in an insurance undertaking responsible for the distribution of insurance-based investment products or linked person, are substantially involved in the management or development of insurance based-investment products, in particular if they have an influence on the pricing of those products or its distribution costs.

Conflicts of interest policy

3. Insurance intermediaries and insurance undertakings shall establish, implement and maintain an effective conflicts of interest policy set out in writing and appropriate to their size and organisation and the nature, scale and complexity of their business. Where the insurance intermediary or insurance undertaking is a member of a group, the policy must also take into account any circumstances, of which the insurance intermediary or insurance undertaking is or should be aware, which may give rise to a conflict of interest arising as a result of the structure and business activities of other members of the group.

4. The conflicts of interest policy established in accordance with paragraph 3 shall include the following content:
 - (a) it must identify, with reference to the specific insurance distribution activities carried out, the circumstances which constitute or may give rise to a conflict of interest entailing a risk of damage to the interests of one or more customers;
 - (b) it must specify procedures to be followed and measures to be adopted in order to manage and prevent such conflicts from damaging the interests of the customer of the insurance intermediary or insurance undertaking, appropriate to the size and activities of the insurance intermediaries or insurance undertaking and of the group to which they belong, and to the risk of damage to the interests of the customer.
5. For the purpose of paragraph 4(b), the procedures to be followed and measures to be adopted shall include, where appropriate, in order to ensure that the distribution activities are carried out in accordance with the best interest of the customer and are not biased by conflicting interests of the insurance undertaking, the insurance intermediary or another customer, the following:
 - (a) effective procedures to prevent or control the exchange of information between relevant persons engaged in activities involving a risk of a conflict of interest where the exchange of that information may damage the interests of one or more customers;
 - (b) the separate supervision of relevant persons whose principal functions involve carrying out activities on behalf of, or providing services to, customers whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the insurance intermediary or insurance undertaking;
 - (c) the removal of any direct link between payments, including remuneration, to relevant persons principally engaged in one activity and payments, including remuneration to different relevant persons principally engaged in another activity, where a conflict of interest may arise in relation to those activities;
 - (d) measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out insurance distribution activities;
 - (e) measures to prevent or control the simultaneous or sequential involvement of a relevant person in insurance distribution activities where such involvement may impair the proper management of conflicts of interest.
6. If insurance intermediaries and insurance undertakings demonstrate that those measures and procedures are not appropriate to ensure that the distribution activities are carried out in accordance with the best interest of the customer and are not biased by conflicting interests of the insurance undertakings, the insurance intermediaries or another customer, insurance intermediaries and insurance undertakings shall adopt adequate alternative measures and procedures for that purpose.
7. The measures and procedures taken by insurance intermediaries or insurance undertakings according to paragraph 4(b), shall be without prejudice to the specific rules on inducements, in particular the obligation to assess the detrimental impact of inducements on the relevant service to the customer.
8. Insurance intermediaries and insurance undertakings shall avoid over reliance on disclosure and shall ensure that disclosure, pursuant to Article 28(2) of

Directive (EU) 2016/97, is a step of last resort that can be used only where the effective organisational and administrative measures established by insurance intermediaries and insurance undertakings to prevent or manage conflicts of interests in accordance with Article 27 thereof are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests of the customer will be prevented.

9. Insurance intermediaries and insurance undertakings shall make that disclosure to customers, pursuant to Article 28(3) of Directive (EU) 2016/97/EC, in a durable medium. The disclosure shall:
 - (a) include a specific description of the conflict of interest, including the general nature and sources of the conflict of interest, as well as the risks to the customer that arise as a result of the conflict of interest and the steps undertaken to mitigate these risks,
 - (b) clearly state that the organisational and administrative arrangements established by the insurance intermediary or insurance undertaking are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests of the customer will be prevented, in order to enable the customer to take an informed decision with respect to the insurance distribution activities in the context of which the conflict of interest arises.
10. Insurance intermediaries and insurance undertakings shall:
 - (a) assess and periodically review – at least annually – the conflicts of interest policy established in accordance with this article and to take all appropriate measures to address any deficiencies, and
 - (b) keep and regularly update a record of the situations in which a conflict of interest entailing a risk of damage to the interests of the one or more customers has arisen or, in the case of an ongoing service or activity, may arise.
11. Where established, senior management of the insurance intermediary or insurance undertaking shall receive on a frequent basis, and at least annually, written reports on these situations.

5. Inducements

Background/mandate

Extract from the Commission's request for advice (mandate)

"EIOPA is invited to provide technical advice on:

- the conditions under which payments and non-monetary benefits paid or received by insurance intermediaries or insurance undertakings in connection with the distribution of an insurance-based investment product may have a detrimental impact on the quality of the relevant service to the customer;*
- the circumstances and situations to take into account when determining whether an insurance distributor or an insurance undertaking paying or receiving inducements complies with its obligation to act honestly, fairly and professionally in accordance with the best interests of the customer.*

The technical advice should specify the methodology to be applied in determining a possible detrimental impact of inducements on the quality of the service and testing compliance with the insurance intermediaries' and insurance undertakings' duty to act in the best interests of its customers. Further clarification should be given with respect to the factual and legal elements and circumstances to take into account in determining whether the conditions set in Article 29(2) are met.

To achieve greater convergence in the application of the detrimental impact criteria, the technical advice should indicate examples of circumstances where a fee, commission or non-monetary benefit may generally be regarded as having a detrimental effect on the quality of the relevant service to the customer. This could be complemented by an exemplary enumeration of circumstances where third-party payments and benefits are generally considered acceptable. In the same way, it should identify circumstances indicating that an insurance intermediary or an insurance undertaking does not comply with the obligation to act honestly, fairly and in accordance with the best interests of the customer.

The technical advice should be consistent with the line taken in the delegated acts expected to be adopted under Article 24(13) of MiFID II, while recognising the difference in terminology between Article 29(2) (a) of the Directive and Article 24(9)(a) of MiFID II".

1. The relevant provisions in the Insurance Distribution Directive are:

Recital 57:

"In order to ensure that any fee or commission or any non-monetary benefit in connection with the distribution of an insurance-based investment product paid to or paid by any party, except the customer or a person on behalf of the customer, does not have a detrimental impact on the quality of the relevant service to the customer, the insurance distributor should put in place appropriate and proportionate arrangements in order to avoid such detrimental impact. To that end, the insurance distributor should develop, adopt and regularly review policies and procedures relating to conflicts of interest with the aim of avoiding any detrimental impact on the quality of the relevant service to the customer and of ensuring that the customer is adequately informed about fees, commissions or benefits".

Article 29(2):

"Without prejudice to points (d) and (e) of Article 19(1) and Article 22(3), Member States shall ensure that insurance intermediaries or insurance undertakings are regarded as fulfilling their obligations under Article 17(1), Article 27 or Article 28 where they pay or are paid any fee or commission, or provide or are provided with any non-monetary benefit in connection with the distribution of an insurance-based investment product or an ancillary service, to or by any party except the customer or a person on behalf of the customer only where the payment or benefit:

- (a) does not have a detrimental impact on the quality of the relevant service to the customer; and*
- (b) does not impair compliance with the insurance intermediary's or insurance undertaking's duty to act honestly, fairly and professionally in accordance with the best interests of its customers."*

Article 29(4):

"Without prejudice to paragraph 3 of this Article, the Commission shall be empowered to adopt delegated acts in accordance with Article 38 to specify:

- (a) the criteria for assessing whether inducements paid or receive by an insurance intermediary or an insurance undertaking have a detrimental impact on the quality of the relevant service to the customer;*
- (b) the criteria for assessing compliance of insurance intermediaries and insurance undertakings paying or receiving inducements with the obligation to act honestly, fairly and professionally in accordance with the best interests of the customer."*

Analysis

2. The Commission's request for advice refers to the "*payments and non-monetary benefits paid or received by insurance intermediaries or insurance undertakings in connections with the distribution of an insurance-based investment product*".
3. Although IDD does not entail an explicit definition of an "inducement", Article 29(2), IDD clarifies that it refers to the payment of any fee or commission as well as the provision of any non-monetary benefit in connection with the distribution of an insurance-based investment product or an ancillary service, to or by any third party except the customer or a person on behalf of the customer. Unlike Article 17(3), IDD, Article 29(2) does not comprise internal payments from insurance distributors to their employees. In addition, the Commission's mandate makes explicit reference to "third party payments and benefits".
4. Therefore, **EIOPA's conclusion is that the Commission is seeking advice in relation to fees or commissions as well as non-monetary benefits paid by or to third parties only, but not in relation to internal payments (e.g. fees paid by the customer or internal payments to employees of insurance distributors).**
5. EIOPA would like to emphasise that EIOPA has an impartial view on the business models of insurance distributors and does not advocate for the establishment of a fee-based distribution model against a commission-based distribution model. At the same time, EIOPA acknowledges that conflicts of interest may arise in both instances which oblige the entities concerned to take appropriate measures to manage these conflicts of interest in order to avoid any damage to customers.
6. EIOPA understands the term, "inducement", as any fee, commission, any other monetary or non-monetary benefit which is paid or provided in connection with the distribution of an insurance-based investment product or an ancillary service to or by any party except the customer or a person on behalf of the customer.
7. Moreover, EIOPA understands the term "inducement scheme" to mean a set of rules that govern the payment of inducements and which generally includes a description of the respective obligations of the person paying the inducements and the person receiving the inducements. It normally outlines the criteria which the recipient of the inducements must achieve in order to earn an inducement and specifies the obligations to pay the inducements. It might elaborate on the amount of the inducement or how the inducement is calculated and any other governance measures in relation to the payment of the inducement. For example, an inducement scheme can be included as part of a contract of appointment between a distributor and a manufacturer.
8. The IDD requires insurance intermediaries and insurance undertakings to apply the general rules laid down in Articles 27 and 28 of the IDD for the identification and the specific requirements on inducements as laid down in Article 29(2) IDD (two step approach):
 - a. In a *first* step, insurance undertakings and insurance intermediaries have to identify all inducements which are paid in connection with the distribution of insurance products.
 - b. In a *second* step, insurance undertakings and insurance intermediaries have to establish adequate procedures to assess whether the inducements have a detrimental impact and of specific organisational measures as outlined below aiming to address the risks of customer detriment caused by the payment of inducements.

9. EIOPA would like to emphasise that the assessment that a specific inducement or inducement scheme has a detrimental impact on the quality of the relevant service, cannot be counterbalanced by any kind of organisational measure or procedure taken in accordance with the general rules on the management of conflict of interest as outlined above.
10. Furthermore, EIOPA would like to emphasise that the disclosure of inducements is specifically addressed by Article 29(1)(c)²⁴ and the second subparagraph of Article 29(1), IDD, as well as Article 19, IDD which entails more general and simple pre-contractual status disclosure which generally precede the general rules on the disclosure of conflicts of interest (see the policy proposals above), including the disclosure as a step of last resort.
11. The Commission has asked EIOPA to provide technical advice on the conditions under which inducements may have a detrimental impact on the quality of the relevant service to the customer.
12. Although EIOPA has been asked by the Commission to ensure "*as much regulatory consistency as possible in the conduct of business standards for IBIPs and financial instruments under MiFID II*", EIOPA notes that the IDD uses different terminology than the respective rules introduced by MiFID II which form the basis of ESMA's technical advice for MiFID II.
13. Whereas MiFID II requires that the inducement "*is designed to enhance the quality of the relevant service to the client*"²⁵, the IDD requires that the inducement does "*not have a detrimental impact on the quality of the relevant service to the customer*"²⁶. From EIOPA's point of view, it is important to adequately consider these differences, which have been agreed upon by the European legislators, when establishing implementing measures for specifying the conditions under which inducements have a detrimental impact on the quality of the services.
14. In view of the cross-sectoral implications, EIOPA believes, however, that the approach for IDD should offer as much compatibility as possible to avoid any unnecessary burden for market participants and to further pursue the goal of a level playing field across the different financial sectors.
15. Against this background, EIOPA proposes to introduce a methodology which is based upon a high-level principle stating the circumstances under which an inducement might have a "*detrimental impact on the relevant service to the customer*". This high-level principle is complemented by a non-exhaustive list of criteria to be considered when assessing whether inducements increase the risk of detrimental impact on the quality of the relevant service to the customer. For the sake of consistency, the high level principle mirrors the general requirement in Article 17(1) of the IDD requiring that "*insurance distributors always act honestly, fairly and professionally in accordance with the best interests of their customers*" when carrying out insurance distribution.
16. According to the methodology proposed by EIOPA, insurance undertakings and insurance intermediaries are required to consider whether one or more of the listed instances increases the risk of detrimental impact on the quality of service. Even if this is the case, this need not automatically lead to the conclusion that the inducement or inducement scheme is detrimental on the quality of the relevant service to the customer. This decision ultimately depends on an overall analysis which should take into consideration all relevant factors which may

²⁴ See the reference to "also encompassing any third party payments".

²⁵ Article 24(9)(a), MiFID II

²⁶ Article 29(2)(a), IDD

increase and decrease the risk of detrimental impact, as well as all organisational measures taken by the insurance undertaking or insurance intermediary aiming to ensure that the inducements do not provide any incentive to carry out the insurance distribution activities in a way which is not in accordance with the best interest of the customer (a "holistic assessment").

17. If none of the listed instances arise in a given situation, the high-level principle still applies. In this case, the focus of the assessment lies on the question whether the inducement or inducement scheme encourage the insurance undertaking or insurance intermediary to carry out distribution activities in a way which is not in accordance with the best interests of the customer. The latter depends on factors such as the respective type, size, design and structure of the inducement or inducement scheme. Here again, the assessment should be based on a holistic assessment which also takes into consideration organisational measures as referred to above.
18. For the sake of clarification, EIOPA would like to point out that, generally speaking, inducements which have a detrimental impact on the quality of the relevant service to the customer, also impair compliance with the insurance intermediary's or insurance undertaking's duty to act honestly, fairly and professionally in accordance with the best interests of its customers (Article 29 (2)(b) IDD). **For this reason, although the Commission's mandate mentions these two aspects separately, they have been analysed together for the purposes of this technical advice.**
19. As outlined, EIOPA proposes to supplement the aforementioned high-level principle with a list of criteria to comply with the Commission's request for EIOPA to list "*examples of circumstances where a fee, commission or non-monetary benefit may generally be regarded as having a detrimental effect on the quality of the relevant service to the customer*".
20. EIOPA would like to clarify, however, that **this list is not supposed to introduce a legal assumption of detrimental impact, but to specify criteria to be considered when assessing whether an inducement or inducement scheme increases the "risk" of exposure to a detrimental impact on the quality of the relevant service to the customer.** EIOPA acknowledges that commission-based distribution is still a widespread practice in some Member States and that commissions are a percentage of the premium paid by the customer for coverage based upon the intermediary's agreement with the insurance undertaking which are, in principle, meant to compensate for services linked to the conclusion of the contract or services provided during the lifetime of the insurance contract. **Therefore, EIOPA would like to emphasise that the objective of this list is not to introduce a *de facto* prohibition on the receipt/payment of inducements, but to provide guidance to market participants in assessing inducements and to point out specific circumstances where there is an increased risk of a detrimental impact. The list builds upon supervisory work of national competent authorities**²⁷

²⁷ For example:

- The NL AFM reported in 2011 about **excessive commissions in the context of the distribution of payment protection insurance (PPI) products** where commissions of up to 86% of the single insurance premium were paid. It was also reported about the successful introduction of national legislation to eliminate "hit and run" practices which are initiated by revenue-related boni. Although referring to non-IBIPs products, this example shows the practical relevance of this issue: <https://www.rijksoverheid.nl/documenten/kamerstukken/2009/06/16/bijlage-provisies-voor-bemiddelaars-in-krediet-beschermers>

and entails payments such as contingent commissions²⁸, profit commissions, upfront commissions and excessive sales targets.

21. With regard to the request from the Commission to provide "an exemplary enumeration of circumstances where third-party payments and benefits are generally considered acceptable", EIOPA would like to emphasise that a "positive list" outlining circumstances generally considered acceptable, entails the high risk of creating loopholes for regulatory arbitrage and might restrict the ability of national competent authorities to take prohibitive action in relation to inducements both *ex ante* and *ex post*. In addition, there is the risk that such a list can become outdated and does not reflect current market and technological developments. It could be very challenging for a supervisory authority to "future-proof" a white list or construct it in such a way so as to ensure that insurance undertakings or insurance intermediaries do not misinterpret it more widely than is intended and in such a way as to circumvent the inducement rules. By way of an example, one national competent authority's supervisory experience was that similar safe harbour provisions in their national law, foiled the achievement of the legislative purpose of strengthening the protection of customers²⁹.

-
- UK FCA guidance on inducements published in January 2014 also provides a steer (<https://www.fca.org.uk/static/documents/finalised-guidance/fq14-01.pdf>). For example, paragraph 2.25 identifies examples of poor practice in relation to payments by providers for development by intermediaries of IT facilities. Similarly, paragraph 2.31 identifies generic examples of poor practices linked to **excessive payments by life insurers to advisory firms to attend their seminars and conferences**. Also para 2.36 refers to amounts of "unreasonable value" when providing gifts/prizes and hospitality.
 - In order to create a sounder market for advice on financial products, the Swedish Finansinspektionen (FI) has proposed a **ban on commissions in connection with investment advice and mediation of life insurance with elements of saving**. FI has specifically highlighted the problems with commissions paid out directly in connection with signing up for products or entering insurance agreements, known as **up-front commissions**. In 2014, the FI conducted a survey of commission income on the advisory market, covering around 200 insurance intermediaries, and firms authorised to conduct securities business. The survey showed that "**among both insurance intermediaries and investment firms, it is very common to have commissions that are paid out in direct connection with the customer purchasing the product, known as upfront commissions**"....."**Upfront commissions are particularly problematic because they also incentivise firms to recommend that consumers frequently switch investments, with the sole purpose of generating fresh commission income for the firm**": http://www.fi.se/upload/90_English/20_Publications/10_Reports/2015/konsumentrapp_2015engNY.pdf
 - In **EIOPA's Third Annual Consumer Trends Report**, it was reported that DE, IE and NO carried out supervisory reviews of selling practices in response to mis-selling cases which found, for example, that sales incentive schemes might have components (**such as the use of thresholds/targets to unlock incentives, 100% variable remuneration**), which encouraged poor sales behaviour. The incentive schemes did not place sufficient emphasis on linking fair treatment of customers (or deterring/penalising poor treatment of customers) with the receipt of incentives: https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-207-Third_Consumer_Trends_Report.pdf
 - In **EIOPA's Fourth Annual Consumer Trends Report**, it was reported that "*some NCAs also reviewed possible conflicts of interest arising from the selection of the underlying funds. If adequate governance and control frameworks are not in place, there is a risk that investments are made on the basis of those which provide the highest commission from fund managers and not in the best interests of the consumer*": https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-15-233%20-%20EIOPA_Fourth_Consumer_Trends_Report.pdf

²⁸ Contingent commissions and profit commissions were also identified by the Commission, as sources of conflict of interest, in the context of its Sector Inquiry on business insurance in 2007 (notwithstanding that this inquiry was primarily focussed on non-life products in the non-retail sector): "*Conflicts of interest that could jeopardise the role of brokers and multiple agents in stimulating competition in the insurance marketplace can also arise from a number of sources, linked to their remuneration, including contingent commissions and fees from services rendered to insurers*". http://ec.europa.eu/competition/sectors/financial_services/inquiries/final_report_annex.pdf

²⁹ In the UK FCA's Inducement rules, it was recognised that some payments or benefits offered by providers to advisory firms can be in the customer's best interests, and the conflicts of interest arising can be managed. Two thematic projects by the FCA following the introduction of the Retail Distribution Review (RDR) showed how some firms took an overly broad interpretation of this to justify a wide range of benefits that in the FCA's view, did not meet the inducements rules. In the end, the FCA was obliged to issue further guidance to dispel any ambiguity around the interpretation of the white list: <https://www.fca.org.uk/publications/finalised-guidance/fq14-1-supervising-retail-investment-advice-inducements-and>

22. Therefore, EIOPA recommends not including such a positive list in the technical advice. However, EIOPA acknowledges that specific circumstances may be considered to decrease the risk of detrimental impact on the quality of the relevant service to the customer and could be taken into consideration as part of an overall assessment.
23. Without prejudice to additional requirements of IDD applicable to insurance distribution, in particular Article 30 IDD, the possibility of Member States to impose stricter requirements as stated in Article 29(3), IDD and the outcome of a thorough overall analysis of all relevant circumstances, the following practices may be considered to decrease the risk that inducements have a detrimental impact on the quality of the service to the customer, if they are appropriately taken into account:
- The inducement scheme allows the insurance undertaking to claim back any inducement in cases where the interests of a customer have been harmed while carrying out insurance distribution activities to the customer;
 - The inducement scheme provides for the prompt refunding of any inducements if the product lapses or is surrendered at an early stage; or
 - The inducement is solely or predominantly based on qualitative criteria, reflecting compliance with the applicable regulations, fair treatment and satisfaction of customers and the quality of services provided to customers on a continuous basis.
24. This list is non-exhaustive and is not intended to create a legal “safe harbour” and should be understood as examples of criteria to be applied in an overall analysis, only. They are deemed to promote more customer-centric behaviour by distributors. **It should be noted that insurance undertakings and insurance intermediaries are, in any case, not relieved from a thorough assessment whether an inducement has a detrimental impact and that these practices may not be adequate or sufficient to mitigate the risk of detrimental impact in an appropriate way, depending on the specific circumstances of the individual case.**
25. Furthermore, EIOPA considers it important that specific organisational measures are introduced to support and ensure that the substantive requirements are fulfilled by regulated entities on an ongoing basis. EIOPA considers that the responsibility and the types of organisational measures will be different for those who pay inducements and those who receive them.
26. Insurance undertakings and insurance intermediaries who pay inducements should have organisational measures in place to assess the design and structure of any inducement scheme which they pay to insurance distributors to ensure it is compliant with Article 29(2). In this context, EIOPA would like to emphasise that insurance undertakings and insurance intermediaries are not required to assess any individual inducement which is paid following the sale of an insurance contract to a particular customer, but only to assess the generic inducement which is paid for selling a particular type of product.
27. Insurance intermediaries and insurance undertakings who receive inducements need to consider the inducement schemes which they are party to, both individually and collectively, and ensure that there are organisational measures in place to ensure that inducements do not lead to detriment for customers and

do not hinder their ability to act honestly, fairly and in accordance with the best interests of their customers.

Inducement and Inducement Scheme

1. An inducement is any fee, commission, or any other monetary or non-monetary benefit which is paid or provided in connection with the distribution of an insurance-based investment product or an ancillary service to or by any party except the customer or a person on behalf of the customer.
2. An inducement scheme is a set of rules that govern the payment of inducements. It generally includes the criteria under which inducements are paid.

Methodology and criteria for assessing the detrimental impact

3. An inducement or inducement scheme has a detrimental impact on the quality of the relevant service to the customer if it is of such a nature and scale that it provides an incentive to carry out insurance distribution activities in a way which is not in accordance with the best interests of the customer.
4. Insurance undertakings and insurance intermediaries shall assess all relevant factors which increase or decrease the risk of detrimental impact on the quality of the relevant service to the customer.
5. Insurance undertakings and insurance intermediaries shall, in particular, take into consideration the following criteria in order to assess whether inducements or inducement schemes increase the risk of detrimental impact:
 - a) the inducement or inducement scheme encourages the insurance intermediary or insurance undertaking carrying out distribution activities to offer or recommend a product or service to a customer when the insurance intermediary or insurance undertaking could, from the outset, propose a different available product or service which would better meet the customer's needs;
 - b) the inducement or inducement scheme is solely or predominantly based on quantitative commercial criteria and does not take into account appropriate qualitative criteria, reflecting compliance with the applicable regulations, fair treatment of customers and the quality of services provided to customers;
 - c) the value of the inducement is disproportionate when considered against the value of the product and the services provided in relation to the product;
 - d) the inducement is entirely or mainly paid upfront when the product is sold without any appropriate refunding mechanism if the product lapses or is surrendered at an early stage;
 - e) the inducement scheme does not provide for an appropriate refunding mechanism if the product lapses or is surrendered at an early stage;
 - f) if the inducement scheme entails any form of variable or contingent threshold or any other kind of value accelerator which is unlocked by attaining a sales target based on volume or value of sales.
6. The list of criteria as laid down in paragraph 5 is non-exhaustive.

Organisational requirements

7. Insurance undertakings and insurance intermediaries shall establish, implement and maintain appropriate organisational arrangements and procedures in order to assess on an ongoing basis and ensure that the generic inducement paid for a particular type of contract and the structure of inducement schemes which they pay to or receive:
 - a. do not lead to a detrimental impact on the quality of the service provided to customers; and
 - b. do not prevent the insurance intermediary or insurance undertaking from complying with their obligation to act honestly, fairly and professionally and in accordance with the best interests of their customers.
8. The assessment shall be based upon an overall analysis which takes into consideration:
 - a) all relevant factors which may increase or decrease the risk of detrimental impact; and
 - b) appropriate organisational measures taken by the insurance undertaking or insurance intermediary to decrease the risk of detrimental impact, which aim to ensure that the inducements do not provide any incentive to carry out the insurance distribution activities in a way which is not in accordance with the best interests of the customer.
9. Insurance undertakings and insurance intermediaries as referred to in paragraph 7 shall ensure that any inducement scheme is approved by the insurance undertaking or insurance intermediary's senior management.
10. Insurance intermediaries and insurance undertakings shall document the assessment referred to in paragraph 8 in a durable medium.
11. As part of the conflicts of interest policy [*as outlined under Section 5 of this technical advice*], insurance intermediaries and insurance undertakings shall set up a gifts and benefits policy that stipulates what gifts and benefits are acceptable and what should happen where limits are breached.

6. Assessment of suitability and appropriateness and reporting to customers

Extract from the Commission's request for advice (mandate)

"EIOPA is invited to provide technical advice on the information to obtain when assessing the suitability or appropriateness of insurance-based investment products for their customers, whereby a distinction has to be made between the situation when advice is provided and the situation when no advice is provided".

"EIOPA is invited to provide technical advice on the content and format of records and agreements for the provision of services to customers".

"EIOPA is invited to provide technical advice on the content and format of periodic reports to customers on the services provided."

1. The following provisions in the Insurance Distribution Directive are relevant to this topic:

Recital 10:

Current and recent financial turbulence has underlined the importance of ensuring effective consumer protection across all financial sectors. It is appropriate, therefore, to strengthen the confidence of customers and to make regulatory treatment of the distribution of insurance products more uniform in order to ensure an adequate level of customer protection across the Union. The level of consumer protection should be raised in relation to Directive 2002/92/EC in order to reduce the need for varying national measures. It is important to take into consideration the specific nature of insurance contracts in comparison to investment products regulated under Directive 2014/65/EU of the European Parliament and of the Council (1). The distribution of insurance contracts, including insurance-based investment products, should therefore be regulated under this Directive and be aligned with Directive 2014/65/EU. The minimum standards should be raised with regard to distribution rules and a level playing field should be created in respect of all insurance-based investment products.

Recital 56:

Insurance-based investment products are often made available to customers as potential alternatives or substitutes to investment products subject to Directive 2014/65/EU. To deliver consistent investor protection and avoid the risk of regulatory arbitrage, it is important that insurance-based investment products are subject, in addition to the conduct of business standards defined for all insurance products, to specific standards aimed at addressing the investment element embedded in those products. Such specific standards should include provision of appropriate information and requirements for advice to be suitable...

Article 2(1)(18):

'durable medium' means any instrument which:

(a) enables a customer to store information addressed personally to that customer in a way accessible for future reference and for a period of time adequate for the purposes of the information; and

(b) allows the unchanged reproduction of the information stored.

Article 20(1):

Prior to the conclusion of an insurance contract, the insurance distributor shall specify, on the basis of information obtained from the customer, the demands and the needs of that customer and shall provide the customer with objective information about the insurance product in a comprehensible form to allow that customer to make an informed decision.

Any contract proposed shall be consistent with the customer's insurance demands and needs.

Where advice is provided prior to the conclusion of any specific contract, the insurance distributor shall provide the customer with a personalised recommendation explaining why a particular product would best meet the customer's demands and needs.

Article 23(1):

All information to be provided in accordance with Articles 18, 19, 20 and 29 shall be communicated to the customer:

(a) on paper;

(b) in a clear and accurate manner, comprehensible to the customer;

(c) in an official language of the Member State in which the risk is situated or of the Member State of the commitment or in any other language agreed upon by the parties; and

(d) free of charge.

Article 29(1):

1. Without prejudice to Article 18 and Article 19(1) and (2), appropriate information shall be provided in good time, prior to the conclusion of a contract, to customers or potential customers with regard to the distribution of insurance-based investment products, and with regard to all costs and related charges. That information shall 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 insurance-based investment products recommended to that customer, referred to in Article 30.

Article 30(1):

Without prejudice to Article 20(1), when providing advice on an insurance-based investment product, the insurance intermediary or insurance undertaking shall also 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, that person's financial situation including that person's ability to bear losses, and that person's investment objectives, including that person's risk tolerance, so as to enable the insurance intermediary or the insurance undertaking to recommend to the customer or potential customer the insurance-based investment products that are suitable for that person and that, in particular, are in accordance with that person's risk tolerance and ability to bear losses.

Member States shall ensure that where an insurance intermediary or insurance undertaking provides investment advice recommending a package of services or products bundled pursuant to Article 24, the overall bundled package is suitable.

Article 30(2):

Without prejudice to Article 20(1), Member States shall ensure that an insurance intermediary or insurance undertaking, when carrying out insurance distribution activities other than those referred to in paragraph 1 of this Article, in relation to sales where no advice is given, asks the customer or potential customer to provide information regarding that person's knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the insurance intermediary or the insurance undertaking to assess whether the insurance service or product envisaged is appropriate for the customer. Where a bundle of services or products is envisaged pursuant to Article 24, the assessment shall consider whether the overall bundled package is appropriate.

Where the insurance intermediary or insurance undertaking considers, on the basis of the information received under the first subparagraph, that the product is not appropriate for the customer or potential customer, the insurance intermediary or insurance undertaking shall warn the customer or potential customer to that effect. That warning may be provided in a standardised format.

Where customers or potential customers do not provide the information referred to in the first subparagraph, or where they provide insufficient information regarding their knowledge and experience, the insurance intermediary or insurance undertaking shall 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.

Article 30(4):

The insurance intermediary or insurance undertaking shall establish a record that includes the document or documents agreed between the insurance intermediary or insurance undertaking 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 contract may be incorporated by reference to other documents or legal texts.

Article 30(5):

The insurance intermediary or insurance undertaking shall provide the customer with adequate reports on the service provided on a durable medium. Those reports shall include periodic communications to customers, taking into account the type and the complexity of insurance-based investment products involved and the nature of the service provided to the customer and shall include, where applicable, the costs associated with the transactions and services undertaken on behalf of the customer.

When providing advice on an insurance-based investment product, the insurance intermediary or the insurance undertaking shall, prior to the conclusion of the contract, provide the customer with a suitability statement on a durable medium specifying the advice given and how that advice meets the preferences, objectives and other characteristics of the customer. The conditions set out in Article 23(1) to (4) shall apply.

Where the contract is concluded using a means of distance communication which prevents the prior delivery of the suitability statement, the insurance intermediary or

the insurance undertaking may provide the suitability statement on a durable medium immediately after the customer is bound by any contract, provided both of the following conditions are met:

- (a) the customer has consented to receiving the suitability statement without undue delay after the conclusion of the contract; and*
- (b) the insurance intermediary or insurance undertaking has given the customer the option of delaying the conclusion of the contract in order to receive the suitability statement in advance of such conclusion.*

Where an insurance intermediary or an insurance undertaking has informed the customer that it will carry out a periodic assessment of suitability, the periodic report shall contain an updated statement of how the insurance-based investment product meets the customer's preferences, objectives and other characteristics of the customer.

Article 30(6):

The Commission shall be empowered to adopt delegated acts in accordance with Article 38 to further specify how insurance intermediaries and insurance undertakings are to comply with the principles set out in this Article when carrying out insurance distribution activities with their customers, including with regard to the information to be obtained when assessing the suitability and appropriateness of insurance-based investment products for their customers..... Those delegated acts shall take into account:

- (a) the nature of the services offered or provided to the customer or potential customer, taking into account the type, object, size and frequency of the transactions;*
- (b) the nature of the products being offered or considered including different types of insurance-based investment products;*
- (c) the retail or professional nature of the customer or potential customer.*

2. The following provisions in Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU ("MiFID II") are relevant to this topic:

Article 25(2)(3):

2. When providing investment advice or portfolio management the investment firm shall 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, that person's financial situation including his ability to bear losses, and his investment objectives including his risk tolerance so as to enable the investment firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him and, in particular, are in accordance with his risk tolerance and ability to bear losses.

Member States shall ensure that where an investment firm provides investment advice recommending a package of services or products bundled pursuant to Article 24(11), the overall bundled package is suitable.

3. Member States shall ensure that investment firms, when providing investment services other than those referred to in paragraph 2, ask the client or potential client to provide information regarding that person's knowledge and experience in the

investment field relevant to the specific type of product or service offered or demanded so as to enable the investment firm to assess whether the investment service or product envisaged is appropriate for the client. Where a bundle of services or products is envisaged pursuant to Article 24(11), the assessment shall consider whether the overall bundled package is appropriate.

Where the investment firm considers, on the basis of the information received under the first subparagraph, that the product or service is not appropriate to the client or potential client, the investment firm shall warn the client or potential client. That warning may be provided in a standardized format.

Where clients or potential clients do not provide the information referred to under the first subparagraph, or where they provide insufficient information regarding their knowledge and experience, the investment firm shall warn them that the investment firm is not in a position to determine whether the service or product envisaged is appropriate for them. That warning may be provided in a standardized format.

3. The following provisions in the draft Commission Delegated Regulation under MiFID II are relevant for this topic:

Article 54 - Assessment of suitability and suitability reports (Article 25(2) of Directive 2014/65/EU):

1. Investment firms shall not create any ambiguity or confusion about their responsibilities in the process when assessing the suitability of investment services or financial instruments in accordance with Article 25(2) of Directive 2014/65/EU. When undertaking the suitability assessment, the firm shall inform clients or potential clients, clearly and simply, that the reason for assessing suitability is to enable the firm to act in the client's best interest.

Where investment advice or portfolio management services are provided in whole or in part through an automated or semi-automated system, the responsibility to undertake the suitability assessment shall lie with the investment firm providing the service and shall not be reduced by the use of an electronic system in making the personal recommendation or decision to trade.

2. Investment firms shall determine the extent of the information to be collected from clients in light of all the features of the investment advice or portfolio management services to be provided to those clients. Investment firms shall obtain from clients or potential clients such information as is necessary for the firm to understand the essential facts about the client and to have a reasonable basis for determining, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of providing a portfolio management service, satisfies the following criteria:

(a) it meets the investment objectives of the client in question, including client's risk tolerance;

(b) it is such that the client is able financially to bear any related investment risks consistent with his investment objectives;

(c) it is such that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

3. Where an investment firm provides an investment service to a professional client it shall be entitled to assume that in relation to the products, transactions and services

for which it is so classified, the client has the necessary level of experience and knowledge for the purposes of point (c) of paragraph 2.

Where that investment service consists in the provision of investment advice to a professional client covered by Section 1 of Annex II to Directive 2014/65/EU, the investment firm shall be entitled to assume for the purposes of point (b) of paragraph 2 that the client is able financially to bear any related investment risks consistent with the investment objectives of that client.

4. The information regarding the financial situation of the client or potential client shall include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments.

5. The information regarding the investment objectives of the client or potential client shall include, where relevant, information on the length of time for which the client wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.

6. Where a client is a legal person or a group of two or more natural persons or where one or more natural persons are represented by another natural person, the investment firm shall establish and implement policy as to who should be subject to the suitability assessment and how this assessment will be done in practice, including from whom information about knowledge and experience, financial situation and investment objectives should be collected. The investment firm shall record this policy.

Where a natural person is represented by another natural person or where a legal person having requested treatment as professional client in accordance with Section 2 of Annex II of Directive 2014/65/EU is to be considered for the suitability assessment, the financial situation and investment objectives shall be those of the legal person or, in relation to the natural person, the underlying client rather than of the representative. The knowledge and experience shall be that of the representative of the natural person or the person authorised to carry out transactions on behalf of the underlying client.

7. Investment firms shall take reasonable steps to ensure that the information collected about their clients or potential clients is reliable. This shall include, but shall not be limited to, the following:

(a) ensuring clients are aware of the importance of providing accurate and up-to-date information;

(b) ensuring all tools, such as risk assessment profiling tools or tools to assess a client's knowledge and experience, employed in the suitability assessment process are fit-for-purpose and are appropriately designed for use with their clients, with any limitations identified and actively mitigated through the suitability assessment process;

(c) ensuring questions used in the process are likely to be understood by clients, capture an accurate reflection of the client's objectives and needs, and the information necessary to undertake the suitability assessment; and

(d) taking steps, as appropriate, to ensure the consistency of client information, such as by considering whether there are obvious inaccuracies in the information provided by clients.

Investment firms having an on-going relationship with the client, such as by providing an ongoing advice or portfolio management service, shall have, and be able to demonstrate, appropriate policies and procedures to maintain adequate and up-to-date information about clients to the extent necessary to fulfil the requirements under paragraph 2.

8. Where, when providing the investment service of investment advice or portfolio management, an investment firm does not obtain the information required under Article 25(2) of Directive 2014/65/EU, the firm shall not recommend investment services or financial instruments to the client or potential client.

9. Investment firms shall have, and be able to demonstrate, adequate policies and procedures in place to ensure that they understand the nature, features, including costs and risks of investment services and financial instruments selected for their clients and that they assess, while taking into account cost and complexity, whether equivalent investment services or financial instruments can meet their client's profile.

10. When providing the investment service of investment advice or portfolio management, an investment firm shall not recommend or decide to trade where none of the services or instruments are suitable for the client.

11. When providing investment advice or portfolio management services that involve switching investments, either by selling an instrument and buying another or by exercising a right to make a change in regard to an existing instrument, investment firms shall collect the necessary information on the client's existing investments and the recommended new investments and shall undertake an analysis of the costs and benefits of the switch, such that they are reasonably able to demonstrate that the benefits of switching are greater than the costs.

Article 55 Provisions common to the assessment of suitability or appropriateness (Article 25(2) and 25(3) of Directive 2014/65/EU)

1. Investment firms shall ensure that the information regarding a client's or potential client's knowledge and experience in the investment field includes the following, to the extent appropriate to the nature of the client, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved:

(a) the types of service, transaction and financial instrument with which the client is familiar;

(b) the nature, volume, and frequency of the client's transactions in financial instruments and the period over which they have been carried out;

(c) the level of education, and profession or relevant former profession of the client or potential client.

2. An investment firm shall not discourage a client or potential client from providing information required for the purposes of Article 25(2) and (3) of Directive 2014/65/EU.

3. An investment firm shall be entitled to rely on the information provided by its clients or potential clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete.

Article 56 Assessment of appropriateness and related record-keeping obligations (Article 25(3) and 25(5) of Directive 2014/65/EU)

1. Investment firms, shall determine whether that client has the necessary experience and knowledge in order to understand the risks involved in relation to the product or investment service offered or demanded when assessing whether an investment service as referred to in Article 25(3) of Directive 2014/65/EU is appropriate for a client.

An investment firm shall be entitled to assume that a professional client has the necessary experience and knowledge in order to understand the risks involved in relation to those particular investment services or transactions, or types of transaction or product, for which the client is classified as a professional client.

7.1 Assessing the suitability or appropriateness of insurance-based investment products

Information to obtain when assessing the suitability and appropriateness of insurance-based investment products

1. Many stakeholders agreed with EIOPA that the assessment of suitability is one of the most relevant regulatory obligations for the purposes of consumer protection. In accordance with this obligation, distributors providing advice have to provide suitable personal recommendations regarding insurance-based investment products to their customers or potential customers. Suitability has to be assessed against the customer's knowledge and experience, financial situation and investment objectives.

Relationship between the "demands and needs" test and the suitability and appropriateness assessments

2. The assessment of suitability and appropriateness is, according to Article 30(1) and 30(2) of IDD, respectively, without prejudice to the "demands and needs" test of Article 20(1) of IDD. (This point is also explicitly recognised in the technical advice below). Before concluding an insurance contract and irrespective of whether this contract is concluded on an advised or non-advised basis, the distributor has to specify the **demands and the needs** of a customer and has to provide the customer with objective information about the insurance product in a comprehensible form to allow that customer to make an informed decision. For that reason, not just insurance-based investment products, but any insurance contract proposed has to be consistent with the customer's insurance demands and needs. Where advice is provided prior to the conclusion of an insurance contract, the distributor should inform the customer why a particular product would best meet the customer's demands and needs.
3. EIOPA appreciates that there is a close relationship between the "demands and needs" test in Article 20(1) of IDD and the suitability/appropriateness assessment under Article 30 of IDD. Although this close relationship exists, EIOPA does not consider it appropriate, at this stage, to develop rules on the demands and needs test in the context of distribution of insurance-based investment products. It is EIOPA's understanding that, due to the fact that the Commission's empowerment for delegated acts on this issue under Article 30(6) of IDD is limited to the "information to obtain under the suitability/appropriateness assessment" (and not the "demands and needs" test) and the fact that this is also reflected in the Commission's Request for Advice, its technical advice should be limited to the information to obtain under the suitability/appropriateness assessment only. This is also in line with the request by the Commission to EIOPA to ensure regulatory consistency with the line taken in the Commission Delegated Regulation under MiFID II.

Information to be obtained from the customer under the suitability and appropriateness assessments

4. Advice is defined as *"the provision of a personal recommendation to a customer, either upon their request or at the initiative of the insurance distributor, in respect of one or more insurance contracts"*³⁰. Therefore, advice is not limited just to the point of sale, but can be provided at any time during the customer relationship. Situations, where periodic advice is provided and recurring

³⁰ Article 2(1)(15), IDD

assessments of suitability are carried out, are just one example of advice during the customer relationship. Every personal recommendation given to the customer has to be suitable, which includes, for example, whether or not to switch embedded investment elements or to hold or sell an insurance-based investment product.

5. The customer's knowledge and experience is a common criterion when assessing suitability or appropriateness. Therefore, assessing the customer's knowledge and experience is relevant to the assessment of suitability and appropriateness equally.
6. The Technical Advice below sets out requirements with regard to the information to obtain for the assessment of suitability and appropriateness and has been adjusted to take into account, specificities arising from the insurance sector:
 - a) Where concepts/terminology contained in MiFID II (e.g. execution of orders, portfolio management) do not exist in the insurance sector;
 - b) Where the MiFID framework allows for assumptions with regard to the assessment of suitability and appropriateness of professional clients³¹, as there is no specific client classification provided for in IDD (other than an exemption in certain cases for "large risks"³²).
7. In addition, in the case of Article 54(9)³³ of the draft MiFID II Delegated Regulation, there is perceived to be an overlap with the envisaged Level 2 provisions on product oversight and governance. For this reason, Article 54(9) has not been replicated in the technical advice below. Copying across Article 54(9), could, in EIOPA's view, create some confusion and legal uncertainty with the product oversight and governance provisions in the envisaged Delegated Act under IDD. At the same time, EIOPA differentiates product oversight and governance clearly from the assessment of suitability and appropriateness by specifying that the rules for the latter apply only when there is direct customer contact while carrying out insurance distribution activities.
8. Furthermore, EIOPA also sees the following difference between the equivalent Level 1 provisions of MiFID II and IDD: There is no comparable provision in Article 25 of IDD, to subparagraph 2 of Article 24(2) of MiFID II which states that an "investment firm shall understand the financial instruments they offer or recommend.....". There is an equivalent provision in subparagraph 4 of Article 25(1) of IDD with subparagraph 4 of Article 16(3) of MiFID II, which refers to the fact that the "insurance undertaking shall understand and regularly review the insurance products it offers or markets". The IDD text does not go as far as referring to a "recommendation". A "recommendation" would provide an obvious link to the suitability assessment under Article 30(1) of IDD. Furthermore, the provision in subparagraph 4 of Article 25(1) of IDD only applies to insurance undertakings and not insurance intermediaries, whereas Article 30(1) of IDD covers both insurance intermediaries and insurance undertakings.
9. EIOPA is of the view that a personal recommendation can only be provided, where the relevant information is available to the distributor. EIOPA acknowledges that understanding the consequences of not being able to provide a personal recommendation is important for distribution activities. Where feasible

³¹ Article 22(1)2), IDD

³² Article 22(1)(1), IDD. N.B. "Large risks" only cover certain non-life products in Annex I of the Solvency II Directive.

³³ "Investment firms shall have, and be able to demonstrate, adequate policies and procedures in place to ensure that they understand the nature, features, including costs and risks of investment services and financial instruments selected their clients and that they assess, while taking into account cost and complexity, whether equivalent investment services or financial instruments can meet their client's profile".

under national law, if a suitability assessment cannot be performed because the necessary information about the customer's financial situation and investment objectives cannot be obtained, an appropriateness assessment could be performed instead on a non-advised basis. However, in cases of Article 30(2) of IDD, in relation to non-professional customers, it would need to be clear to the customer or potential customer that he is not receiving a personal recommendation.

Assessment of suitability

1. The insurance intermediary or insurance undertaking when carrying out an insurance distribution activity, shall determine the extent of the information to be collected from the customer in light of all the features of the advice to be provided to the customer or potential customer.
2. Without prejudice to the fact that any contract of insurance proposed shall be consistent with the customer's insurance demands and needs under Article 20(1) of Directive (EU) 2016/97, an insurance intermediary or insurance undertaking shall obtain from customers or potential customers such information as is necessary for the insurance intermediary or the insurance undertaking to understand the essential facts about the customer and to have a reasonable basis for determining that the personal recommendation satisfies the following criteria:
 - (a) it meets the customer's investment objectives, including that person's risk tolerance;
 - (b) it meets the customer's financial situation, including that person's ability to bear losses;
 - (c) it is such that the customer has the necessary knowledge and experience in the investment field relevant to the specific type of product or service.
3. It may be the case that some information to be obtained for the suitability assessment is obtained already under Chapter V of Directive (EU) 2016/97.
4. The insurance intermediary or the insurance undertaking shall not create any ambiguity or confusion about their responsibilities in the process when assessing the suitability in accordance with Article 30(1) of Directive (EU) 2016/97. The insurance intermediary or insurance undertaking shall inform customers, clearly and simply, that the reason for assessing suitability is to enable them to act in the customer's best interest.
5. When advice on insurance-based investment products is provided in whole or in part through an automated or semi-automated system, the responsibility to undertake the suitability assessment shall lie with the insurance intermediary or insurance undertaking providing the service and shall not be reduced by the use of an electronic system in making the personal recommendation.
6. The necessary information regarding the customer's or potential customer's financial situation including that person's ability to bear losses, shall include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments. The level of information gathered shall be appropriate to the specific type of product or service being considered.
7. The necessary information regarding the customer's or potential customer's investment objectives, including that person's risk tolerance, shall include, where relevant, information on the length of time for which the customer wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment. The level of information gathered shall be appropriate to the specific type of product or service being considered.

8. With reference to group insurance as referred to in recital 49 of Directive (EU) 2016/97, where an insurance contract is concluded on behalf of a group of members, where the individual member cannot take an individual decision to join, the insurance intermediary or insurance undertaking shall establish and implement policy as to who shall be subject to the suitability assessment and how this assessment will be done in practice, including from whom the information about knowledge and experience, financial situation and investment objectives shall be collected. The insurance intermediary or the insurance undertaking shall record this policy.
9. The insurance intermediary or insurance undertaking shall take reasonable steps to ensure that the information collected about the customer is reliable. This shall include, but shall not be limited to, the following:
 - (a) ensuring customers are aware of the importance of providing accurate and up-to-date information;
 - (b) ensuring all tools, such as risk assessment profiling tools or tools to assess a customer's knowledge and experience, employed in the suitability assessment process are fit-for-purpose and appropriately designed for use with their customers, with any limitations identified and actively mitigated through the suitability assessment process;
 - (c) ensuring questions used in the process are likely to be understood by the customer, capture an accurate reflection of the customer's objectives and needs, and the information necessary to undertake the suitability assessment; and
 - (d) taking steps, as appropriate, to ensure the consistency of customer information, such as considering whether there are obvious inaccuracies in the information provided by the customer.
10. If the insurance intermediary or insurance undertaking does not obtain the information required under Article 30(1) of Directive (EU) 2016/97, the insurance intermediary or the insurance undertaking shall not provide advice on insurance-based investment products to the customer or potential customer.
11. When providing the advice, an insurance intermediary or the insurance undertaking shall not make a recommendation where none of the products are suitable for the customer.
12. When providing advice that involves switching between underlying investment assets, such as by exercising a contractual right to make a change in regard to an underlying investment asset, the insurance intermediary or insurance undertaking shall also collect the necessary information on the customer's existing underlying investment assets and the recommended new investments and shall undertake an analysis of the costs and benefits of the switch, such that they are reasonably able to demonstrate that the benefits of switching are greater than the costs.

Provisions common to the assessment of suitability or appropriateness

13. The necessary information regarding the customer's or potential customer's knowledge and experience in the investment field, shall include, where relevant the following to the extent appropriate to the specific type of product or service:
 - (a) the types of service, transaction, insurance-based investment product or financial instrument with which the customer is familiar;
 - (b) the nature, volume, and frequency of the customer's transactions in insurance-based investment products or financial instruments and the period over which they have been carried out;
 - (c) the level of education, and profession or relevant former profession of the customer or potential customer.
14. An insurance intermediary or the insurance undertaking shall not discourage a customer or potential customer from providing information required for the purposes of Article 30(1) and (2) of Directive (EU) 2016/97.
15. An insurance intermediary or the insurance undertaking shall be entitled to rely on the information provided by its customers or potential customers unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete.

Assessment of appropriateness

16. Without prejudice to the fact that any contract of insurance proposed shall be consistent with the customer's insurance demands and needs under Article 20(1) of Directive (EU) 2016/97, the insurance intermediary or insurance undertaking, when carrying out insurance distribution activities other than those referred to in Article 30(1) of Directive (EU) 2016/97, in relation to assessing the appropriateness of sales where no advice is given, shall determine whether that customer has the necessary experience and knowledge in order to understand the risks involved in relation to the product proposed.

7.2 Retention of records

Analysis

1. The technical advice developed by ESMA on MiFID II and the Delegated Regulation under MiFID II adopted by the European Commission on 25 April 2016 have served as a basis for this part of the technical advice. The results of EIOPA's online survey in early 2016³⁴ showed a general support for alignment with MiFID II requirements, which was reinforced by the outcome of the public consultation. Respondents agreed that insurance specificities should be taken into account in the technical advice.
2. EIOPA acknowledges that the draft MiFID II Delegated Regulation covers record-keeping in an appropriateness scenario only, and does not introduce specific rules for the content of records for the suitability assessment. Furthermore, the draft MiFID II Delegated Regulation does not provide more information about the format for records. EIOPA has taken note of ESMA's Guidelines on certain aspects of the MiFID suitability requirements³⁵, where certain expectations with regard to record-keeping of the assessment of suitability were set.
3. With particular reference to the content of the agreements for the provision of services to customer, the draft MiFID II Delegated Regulation does not reflect specificities of the insurance sector. In particular, it refers to the written basic agreement between the investment firm and the retail client, which Member State will require the investment firm to enter into with the latter, as provided by Article 58, draft MiFID II Delegated Regulation. Taking into account that the same written basic agreement is not foreseen by IDD, the reference to "*the agreements for the provision of services to customers*" mentioned by the Commission's request for advice, does not seem to be applicable in the IDD context. IDD mentions the documents agreed between the parties only, but does not introduce the concept of a written basic agreement.
4. Therefore, the reference to the written basic agreements for the provision of services to the customer could be interpreted as a reference to the contractual terms and conditions in which the essential rights and obligations of the parties are regulated. Member States might want to introduce this concept at their own discretion or have done so already.
5. In fact, although from a formal point of view, IDD does not introduce the concept and the requirement of the written basic agreement (but only mentions the documents agreed between the insurance intermediary or insurance undertaking and the customer), the content of the written basic agreement does not appear inconsistent with the IDD framework, except for those features specifically referred to under MiFID II and not adapted to the specificities of the insurance market (e.g. the reference to portfolio management, custody services and financing transactions).

Retention of records on suitability assessments

6. As regards the Commission's request for advice about the content of the agreements for the provision of services to customers, it was also pointed out by many respondents to EIOPA's online survey that the fact that the content of insurance contracts is already regulated at national level, should be also taken into account. Therefore, the definition of the information to be included in the contract at EU level could interfere with national civil law. For this reason, with

³⁴ <https://eiopa.europa.eu/Pages/Consumer-Protection/Online-survey-Call-for-Advice-from-EC-IDD.aspx>

³⁵ Section V.IX on Record-keeping: https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-387_en.pdf

reference to the documents agreed between the insurance intermediary or insurance undertaking and the customer setting out the rights and obligation of the parties which the insurance intermediary or insurance undertaking is obliged to record, the rules on retention of records remain high level.

7. As regards the content of records on suitability assessments, the insurance intermediary or insurance undertaking should keep a record of the insurance-based investment products that were recommended, but not record all potential products that could have been alternatives. This ensures that the provision of advice and the record-keeping obligations for this service are aligned.

Format of the documents agreed between the parties

8. In relation to the Commission's request for advice about the format of records and agreements for the provision of services to customers, Article 30(5) of IDD already refers to "durable medium" in relation to periodic reports to customers on the services provided and to the suitability statements to be provided to the customer.
9. EIOPA has taken note that the draft MiFID II Delegated Regulation has a number of provisions on format, such as Articles 46 and Article 58. Accordingly, the technical advice specifies the format for record-keeping and reporting purposes to make Article 30 of IDD, more practical and allow national competent authorities to supervise market practice.
10. Therefore, it would be sufficient to make a reference to the notion of durable medium as defined by Article 2(1)(18) of IDD, which states the following:
"durable medium" means any instrument which:
 - (a) enables a customer to store information addressed personally to that customer in a way accessible for future reference and for a period of time adequate for the purposes of the information; and*
 - (b) allows the unchanged reproduction of the information stored".*
11. EIOPA acknowledges the challenges for distributors with regard to providing documents in the most suitable format. EIOPA believes it is useful to make a reference to the general provisions on the information conditions laid down by Article 23 of IDD (as regards the use of paper or another durable medium and the use of the official language of the Member State in which the risk is situated or of the Member State of the commitment or in any other language agreed upon by the parties).
12. Article 23 introduces certain criteria when deviating from the default paper-based format. These criteria should be understood in a pragmatic way that is in accordance with the best interests of the customer.

Retention of records

1. Without prejudice to the application of the Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 (General Data Protection Rules), the insurance intermediary or insurance undertaking shall keep orderly records of information obtained where the insurance intermediary or the insurance undertaking is required to produce a suitability statement or the customer information obtained to assess appropriateness.

Record-keeping obligations for the assessment of suitability

2. The insurance intermediary or the insurance undertaking shall at least:
 - (a) maintain adequate recording and retention arrangements to ensure orderly and transparent record-keeping regarding the suitability assessment, including any advice provided, the result of the suitability assessment and all changes to the underlying investment assets; in order to not prevent competent authorities from fulfilling their supervisory objectives with particular reference to the detection of failures;
 - (b) ensure that records kept are accessible for the relevant persons within the insurance intermediary or insurance undertaking, and for competent authorities; and
 - (c) have adequate processes to mitigate any shortcomings or limitations of the record-keeping arrangements.
3. The insurance intermediary or the insurance undertaking shall record all relevant information about the suitability assessment, such as information about the customer, and information about insurance-based investment products recommended to the customer or purchased on the customer's behalf. Those records shall include:
 - (a) any changes made by the insurance intermediary or the insurance undertaking regarding the suitability assessment, in particular any change to the customer's risk tolerance;
 - (b) the recommended insurance-based investment products that fit that profile and the rationale for the individual assessment, as well as any changes and the reasons for them.

Record-keeping obligations for the assessment of appropriateness

4. Insurance intermediary or insurance undertaking shall maintain records of the appropriateness assessments undertaken which shall include the following:
 - (a) the result of the appropriateness assessment;
 - (b) any warning given to the customer where the product was assessed as potentially inappropriate for the customer, whether the customer asked to proceed with concluding the contract despite the warning and, where applicable, whether the insurance undertaking or the insurance intermediary accepted the customer's request to proceed with concluding the contract; and
 - (c) any warning given to the customer where the customer did not provide sufficient information to enable the insurance undertaking or the insurance

intermediary to undertake an appropriateness assessment, whether the customer asked to proceed with concluding the contract despite this warning and, where applicable, whether the insurance undertaking or the insurance intermediary accepted the customer's request to proceed with concluding the contract.

Format

5. With reference to the format, the documents as referred to in paragraph 1 shall be kept and provided:
 - a) in an official language of the Member State in which the risk is situated or in the Member State where the consumer has his habitual residence under the conditions of Article 6 of the Regulation 593/2008 on the law applicable to contractual obligations (Rome I) or in any other language agreed upon by the parties;
 - b) in a clear and accurate manner, comprehensible to the customer;
 - c) in the format as defined by Article 2(1)(18) of Directive (EU) 2016/97.

7.3 Reports to customers on the services provided

Analysis

1. EIOPA has been asked to provide advice on periodic reports to customers on the services provided. Notwithstanding that the suitability statement is a one-off document, EIOPA has included the suitability statement in this part of the analysis and advice. EIOPA is of the view that providing the one-off statement and a periodic suitability assessment should be dealt with together.
2. Reporting obligations should include a fair and balanced review of the activities undertaken and of the performance during the relevant period. The reports on the services provided, should be provided in a durable medium.

Suitability statement

3. EIOPA acknowledges that distributors, when providing advice, will usually take into account all information available. The IDD includes in Chapter V, the demands and needs test, which existed already in the IMD and is applicable to all insurance contracts. According to Article 20(1) of IDD, prior to the conclusion of an insurance contract, the insurance distributor shall specify, on the basis of information obtained from the customer, the demands and the needs of that customer. EIOPA expects that the suitability statement will focus on the elements of the suitability assessment and does not intend to introduce with its technical advice, any form of mandatory "demands and needs statement".
4. When an advice is provided to the customer regarding insurance-based investment products, the suitability statement has to provide feedback on the customer-specific information, which has been gathered and analysed in order to make the recommendation of a suitable contract, transparent.
5. The suitability statement should therefore contain at least:
 - An outline of the advice given; and
 - How the recommendation provided, is suitable for the customer.

Periodic Suitability report

6. EIOPA considers the periodic suitability report referred to in Article 30(5) of IDD to be an on-going and regular revision of the initial suitability assessment, to be agreed upon by the parties, with the aim of determining whether the product is still in accordance with the best interests of their customers. Taking into account that insurance-based investment products have usually medium to long recommended holding periods, a frequency of one year is appropriate to meet the objectives.
7. EIOPA considers it proportionate that a periodic suitability report covers in certain circumstances only, changes in the services or investments embedded in the insurance-based investment product and/or the circumstances of the customer and may not need to repeat all the details of the first report.
8. In the cases where a periodic assessment of suitability is agreed, a customer should be able to trust that this review takes place at least annually. However, if the assessment shows that the product is not in accordance with the best interests of the customer anymore, the customer should be informed without undue delay after the assessment.
9. If the assessment shows that the product is still suitable, EIOPA considers it sufficient to refer to the periodic assessment in the periodic communications to

the customer. This would also be proportionate and would not overwhelm the customer with too much information.

Periodic communications to customers

10. EIOPA understands that adequate reports on the service provided are mandatory according to Article 30(5) of IDD. In practice, they might not be separable from other customer communication and could be delivered together with other documents or even electronically.
11. EIOPA refers in its technical advice to services provided to and transactions undertaken on behalf of customers. This is due to the fact that IDD specifies that *"reports shall include periodic communications to customers, taking into account the type and the complexity of insurance-based investment products involved and the nature of the service provided to the customer and shall include, where applicable, the costs associated with the transactions and services undertaken on behalf of the customer"*. EIOPA expects the periodic communication to disclose to the customer the costs that are incurred by transactions, which is understood with regard to changes to the underlying investment assets in insurance-based investment products.
12. The recommended frequency of adequate reports on the service provided should be yearly. EIOPA acknowledges that reporting under MiFID II in the case of portfolio management, foresees quarterly reporting. However, substantial differences exist in EIOPA's view between reporting with regard to portfolio management and periodic communications with regard to insurance-based investment products. Mainly, in the case of insurance-based investment products, the recommended holding period is generally several years, whereas portfolio management can encompass all sorts of financial instruments to report on.
13. At the same time, EIOPA recognises the similarities of portfolio management and periodic communications with regard to insurance-based investment products. Therefore, EIOPA considers it important to report on relevant information. EIOPA has reviewed such information in light of the responses received during the public consultation. It is not EIOPA's intention to call into question the reporting already foreseen under Article 185 of Solvency II. Furthermore, the reporting criteria should be in principle applicable to all kinds of insurance-based investment products. Therefore, EIOPA is putting forward a proposal for core elements of relevant customer information, while acknowledging that other information provision clauses exist in relevant legislation.
14. With the proposed amendments to the list of elements required for meaningful periodic communication to customers, EIOPA expects in practice a clearer demarcation of reporting obligations for insurance undertakings (reporting foreseen by Article 185 of Solvency II) and periodic communications following from the direct customer relationship, Article 30(5) of IDD. EIOPA expects that the periodic communication goes beyond the criteria prescribed, if the products involved or the nature of the service provided warrant for the communication of additional elements. Ultimately, customers should be informed about the necessary developments while not being overloaded with too much information.

Suitability statement

1. When providing advice, the insurance intermediary or insurance undertaking shall provide a statement to the customer that includes an outline of the advice given and how the recommendation provided is suitable for the customer, including how it meets the customer's investment objectives, including that person's risk tolerance; the customer's financial situation, including that person's ability to bear losses; and the customer's knowledge and experience.
2. The insurance intermediary or insurance undertaking shall draw the customer's attention to, and shall include in the suitability statement, information on whether the recommendation is likely to require the customer to seek a periodic review of their arrangements.
3. Where an insurance intermediary or insurance undertaking has informed the customer that it will carry out a periodic assessment of suitability, the subsequent reports after the initial service is established, may only cover changes in the services or underlying investment assets and/or the circumstances of the customer and may not need to repeat all the details of the first report.
4. Insurance intermediary or insurance undertaking providing a periodic suitability assessment shall review, in accordance with the best interests of their customers, the suitability of the recommendations given at least annually.
5. The frequency of this assessment shall be increased depending on the characteristics of the customer, such as the risk tolerance of the customer, and the insurance-based investment product recommended.
6. The insurance intermediary or insurance undertaking providing a periodic suitability assessment pursuant to paragraph 3, shall disclose all of the following:
 - (a) the frequency and extent of the periodic suitability assessment and where relevant, the conditions that trigger that assessment;
 - (b) the extent to which the information previously collected will be subject to reassessment; and
 - (c) the way in which an updated recommendation will be communicated to the customer.

Periodic communications to customers

7. Without prejudice to Article 185 of Directive 2009/138/EC (Solvency II), the insurance intermediary or insurance undertaking shall provide the customer with a periodic statement in a durable medium of the services provided to and transactions undertaken on behalf of that customer.

8. The periodic statement required under paragraph 7, shall provide a fair and balanced review of the services provided to and transactions undertaken on behalf of that customer and shall include the following information:
 - (a) Services provided to and transactions undertaken on behalf of the customer during the reporting period and, where applicable, the costs associated with these services and transactions (if any);
 - (b) Value of each underlying investment asset, where appropriate;
9. The periodic statement referred to in paragraph 7 shall be provided at least annually.

8. Execution-only sales - criteria to assess “other non-complex insurance-based investment products”

Extract from the Commission’s request for advice (mandate)

“EIOPA is invited to provide technical advice on the criteria to assess non-complex insurance-based investment products for the purposes of point (ii) of point (a) of paragraph 3 of Article 30”.

1. The following provisions in the IDD are relevant to this topic:

Article 30(3)(a):

3. Without prejudice to Article 20(1), where no advice is given in relation to insurance-based investment products, Member States may derogate from the obligations referred to in paragraph 2 of this Article, allowing insurance intermediaries or insurance undertakings to carry out insurance distribution activities within their territories without the need to obtain the information or make the determination provided for in paragraph 2 of this Article where all the following conditions are met: (a) the activities refer to either of the following insurance-based investment products (i) contracts which only provide investment exposure to the financial instruments deemed non-complex under Directive 2014/65/EU and do not incorporate a structure which makes it difficult for the customer to understand the risks involved; or (ii) other non-complex insurance-based investments for the purpose of this paragraph;

Article 30(6):

The Commission shall be empowered to adopt delegated acts in accordance with Article 38 to further specify how insurance intermediaries and insurance undertakings are to comply with the principles set out in this Article when carrying out insurance distribution activities with their customers, including with regard to...the criteria to assess non-complex insurance-based investment products for the purposes of point (ii) of point (a) of paragraph 3 of this Article...Those delegated acts shall take into account:

(a) the nature of the services offered or provided to the customer or potential customer, taking into account the type, object, size and frequency of the transactions;

(b) the nature of the products being offered or considered including different types of insurance-based investment products;

(c) the retail or professional nature of the customer or potential customer”.

2. The following provisions in the draft Commission Delegated Regulation under Directive 2014/65/EU (“MiFID II”) are relevant for this topic:

Article 57 - Provision of services in non-complex instruments (Article 25(4) of Directive 2014/65/EU):

A financial instrument which is not explicitly specified in Article 25(4)(a) of Directive 2014/65/EU shall be considered as non-complex for the purposes of Article 25(4)(a)(vi) of Directive 2014/65/EU if it satisfies the following criteria:

(a) it does not fall within Article 4(1)(44)(c) of, or points (4) to (11) of Section C of Annex I to Directive 2014/65/EU;

(b) there are frequent opportunities to dispose of, redeem, or otherwise realise that instrument at prices that are publicly available to market participants and that are either market prices or prices made available, or validated, by valuation systems independent of the issuer;

(c) it does not involve any actual or potential liability for the client that exceeds the cost of acquiring the instrument;

(d) it does not incorporate a clause, condition or trigger that could fundamentally alter the nature or risk of the investment or pay out profile, such as investments that incorporate a right to convert the instrument into a different investment;

(e) it does not include any explicit or implicit exit charges that have the effect of making the investment illiquid even though there are technically frequent opportunities to dispose of, redeem or otherwise realise it;

(f) adequately comprehensive information on its characteristics is publicly available and is likely to be readily understood so as to enable the average retail client to make an informed judgment as to whether to enter into a transaction in that instrument."

Analysis

3. In accordance with paragraphs 1 and 2 of Article 30 of IDD an assessment of the suitability or appropriateness of an insurance-based investment product for the customer by the insurance distributor is generally required as part of an advised or non-advised sale. However, Article 30(3) of IDD allows Member States to derogate from these obligations and to not require either a suitability or appropriateness test to be conducted, where various conditions are satisfied. This type of sale is often referred to as an "execution-only" sale, as the insurance undertaking or insurance intermediary executes the transaction requested by the customer without any prior vetting of the customer's knowledge, experience, financial situation and investment objectives. The sale is carried out only at the initiative of the customer or the potential customer. However, it is important to note that, in accordance with Article 20(1) of IDD, it is still necessary for the insurance distributor to specify the demands and needs of the customer prior to the conclusion of the contract.
4. Since the assessment of whether the conditions in Article 30(3) of IDD are satisfied is only necessary where Member States choose to exercise the derogation, and thereby allow for the execution-only sale of insurance-based investment products, the application of the term "other non-complex insurance-based investments" for the purposes of Article 30(3)(a) will only be directly relevant within those Member States which make use of the derogation.

5. One of the conditions specified in Article 30(3) to determine whether an insurance-based investment product can be distributed as an execution-only sale relates to the complexity of the insurance-based investment product. This assessment is based on the nature of the financial instruments to which the insurance-based investment provides investment exposure, as well as the structure of the contract between the insurance undertaking or insurance intermediary and the customer (Article 30(3)(a), IDD).
6. Under Article 30(3)(a)(i) of IDD insurance-based investment products can be considered non-complex when they only provide investment exposure to the financial instruments deemed non-complex under MiFID II and do not incorporate a structure which makes it difficult for the customer to understand the risks involved. The list of specified non-complex financial instruments in MiFID II is relatively short – it is limited to certain types of shares, bonds, money-market instruments and structured deposits, and non-structured UCITS, as set out in Article 25(4)(a) of MiFID II:
 - (a) shares admitted to trading on a regulated market or an equivalent third country market (that is, one which is included in the list which is published by the European Commission and updated periodically) or on a MTF³⁶, where those are shares in companies, and excluding shares in non-UCITS collective investment undertakings and shares that embed a derivative;
 - (b) bonds or other forms of securitised debt admitted to trading on a regulated market or on an equivalent third country market or on a MTF, excluding those that embed a derivative or incorporate a structure which makes it difficult for the client to understand the risk involved;
 - (c) money-market instruments, excluding those that embed a derivative or incorporate a structure which makes it difficult for the client to understand the risk involved;
 - (d) shares or units in UCITS, excluding structured UCITS as referred to in the second subparagraph of Article 36(1) of Regulation (EU) No 583/2010;
 - (e) structured deposits, excluding those that incorporate a structure which makes it difficult for the client to understand the risk of return or the cost of exiting the product before term; or
 - (f) other non-complex financial instruments.
7. In accordance with Article 25(8) of MiFID II, the Commission is empowered to adopt delegated acts on the criteria identify “other non-complex financial instruments” referred to in Article 25(4)(a)(vi) of the same Directive. The current text of the MiFID II delegated acts is included in paragraph 2 of this section above. ESMA has also drafted Guidelines on complex debt instruments and structured deposits to clarify the application of the list in Article 25(4)(a) of MiFID II (and included in the previous paragraph of this section). All of these provisions are therefore relevant when assessing whether the investment exposure of an insurance-based investment product is limited to financial instruments deemed non-complex under MiFID II.
8. Article 30(3)(a)(ii) of IDD acknowledges the possibility that an insurance-based investment product may not fall within the scope of Article 30(3)(a)(i), but may

³⁶ Multi-lateral trading facility

still be deemed a non-complex product. EIOPA considers that where an insurance-based investment product incorporates a structure which makes it difficult for the customer to understand the risks involved, it is in all cases not fit for distribution via an execution-only sale. For this reason, the technical advice below contains a provision to exclude cases where the insurance-based investment product incorporates a structure which makes it difficult for the customer to understand the risks involved (point (e) below in the sub-section "Technical Advice"). This criterion mirrors the drafting of Article 30(3)(a)(i). Adding it in the technical advice below aims to achieve symmetry within point (a) of Article 30(3).

9. EIOPA is also working on further specifying which structures can make it difficult for the customer to understand the risks involved in accordance with the empowerments to develop Guidelines in Articles 30(7) and (8) of IDD and will publish shortly a consultation paper on those Guidelines³⁷. For the purpose of this technical advice, EIOPA has considered whether there are cases where an insurance-based investment product provides some kind of investment exposure to complex financial instruments³⁸ or to other variables, but overall the product can still be fit for distribution via execution-only.
10. The results of EIOPA's evidence-gathering³⁹ on suitability and appropriateness with regard to Article 30(3)(a)(ii) of IDD indicate that there are a limited number of insurance-based investment product types currently sold execution-only. Whilst numerous Member States allow for the sale of certain products on a non-advised basis, only a limited number allow for products to be sold by means of execution-only transactions. An example of an insurance-based investment product, which may already be sold on this basis, is a limited term "investment bond-type" product, either with single or regular premiums, which has life insurance cover.
11. EIOPA is also mindful of the importance of the assessments of suitability and appropriateness to ensure good outcomes for customers, and therefore the need to carefully circumscribe the types of products that can be sold without these protection measures. At the same time, EIOPA is aware that to unduly restrict these sales, as well as to minimise the development of future products for sale by execution-only, could be seen as anti-competitive or as resulting in financial exclusion by limiting the development of low-cost simple products.
12. Some Member States have advocated retention of some discretion over the assessment of complexity at local level, in view of the differences in markets and product features across Member States. It can also be noted that, in view of the minimum harmonisation aim of IDD as well as the fact that for execution-only sales specifically customers do not benefit from the protection of some of the relevant conduct of business rules, some national supervisory authorities have indicated that they may maintain or introduce more stringent national provisions in this area. The drafting of the criteria therefore bears in mind the need for them to be capable of general application by Member States having regard to their specific statutory regimes.

³⁷ Under Article 30(7) EIOPA has to issue those Guidelines by 23 August 2017. There is no deadline for the empowerment in Article 30(8).

³⁸ This means that they would not satisfy the conditions in Article 30(3)(a)(i).

³⁹ EIOPA conducted a survey in preparation for this technical advice, the responses to which can be found [here](#).

13. EIOPA has noted the draft Commission Delegated Regulation under MiFID II regarding criteria for the assessment of other non-complex financial instruments. Where these criteria address product features, which are considered to be equally applicable to insurance-based investment products, these provisions are included in EIOPA's technical advice. This includes provisions on the ability to redeem (i.e. surrender) a product before the contractual maturity date, the nature of the exit (i.e. surrender) charges and fact that they should not be punitive or prohibitive, and the existence of clauses or triggers which alter the risk of the product. However, in these cases it was still necessary to modify some of the MiFID II requirements to appropriately reflect the insurance sector. In particular, regarding the provision in point (d) of the technical advice, given that exit penalties have been a feature of long-term insurance-based investment products that are considered to have led to consumer detriment, this is intended to exclude products with unreasonable exit charges, including fiscal penalties.
14. The provisions in Article 57 sub paragraph 1, points (a), (c) and (f) of the MiFID II draft Commission Delegated Regulation were not considered applicable to insurance-based investment products. Point (a) is considered to be specific to MiFID II as it concerns the complexity of the underlying financial instruments. Regarding point (c) it is not considered to be possible for an insurance-based investment product to result in a liability for the customer, which exceeds the amount of the premiums to be paid. Regarding point (f), this is not considered to be necessary given that adequately comprehensive information should be available for all insurance-based investment products, not only those sold via execution-only, in accordance with Articles 20(1) and 29(1) of IDD, as well as Regulation 1286/2014 on Key Information Documents (KID) for Packaged Retail and Insurance-based Investment Products (PRIIPs).
15. Another relevant consideration is the **nature of any guarantee** provided by the insurance undertaking. Where the insurance undertaking provides a guarantee regarding the surrender and maturity value of an insurance-based investment product, the customer is not fully exposed to the performance of the financial instruments in which the insurance undertaking has invested or to which the customer's benefits are linked. In view of this, depending on the nature of the guarantee, insurance-based investment products could be regarded as non-complex, even though the contract may provide investment exposure that is not limited to financial instruments deemed non-complex under MiFID II. In this case, EIOPA considers that as a minimum the customer should be guaranteed to receive, at both surrender and maturity, at least the amount of the premiums that they have paid, minus legitimate costs levied. Furthermore, whilst the provision of a guarantee significantly limits the extent to which the customer is exposed to market fluctuations, there will still be an investment element to the product which determines the extent to which the maturity value is above the guaranteed level. For this reason, as stated in paragraph 8 above, it is critical that the insurance-based investment product also does not incorporate a structure which makes it difficult for the customer to understand the risks involved.
16. **Notwithstanding the process for adopting the delegated acts referred to in Article 30(6) of IDD, as determined by the Commission, in view of the close connection between this technical advice and the Guidelines based on the empowerments in Article 30(7) and (8) of IDD, EIOPA considers that it may be appropriate to review its technical advice in light of the comments received during the public consultation on the Guidelines.**

Technical Advice

An insurance-based investment product shall be considered as non-complex for the purposes of Article 30(3)(a)(ii) of Directive (EU) 2016/97 if it satisfies all of the following criteria:

- (a) the contractually guaranteed minimum surrender and maturity value is at least the amount of premiums paid by the customer minus legitimate costs levied.
- (b) it does not incorporate a clause, condition or trigger that allows the insurance undertaking to materially alter the nature, risk or pay-out profile of the insurance-based investment product;
- (c) there are options to surrender or otherwise realise the insurance-based investment product at a value that is available to the customer;
- (d) it does not include any explicit or implicit charges which have the effect that, even though there are technically options to surrender the insurance-based investment product, doing so may cause unreasonable detriment to the customer, because the charges are disproportionate to the cost to the insurance undertaking of the surrender;
- (e) it does not in any other way incorporate a structure which makes it difficult for the customer to understand the risks involved.

Annex I: Impact Assessment

Procedural issues and consultation of interested parties

The Commission has requested EIOPA to provide technical advice on possible delegated acts concerning Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (hereinafter "IDD"). In particular, the Commission seeks EIOPA's technical advice regarding the following issues:

- A. Product oversight and governance,
- B. Conflicts of interest,
- C. Inducements and
- D. Assessment of suitability and appropriateness and reporting to customers.

According to the Commission's request, EIOPA should justify its advice by identifying, where relevant, a range of technical options and undertaking a qualitative, and as far as possible, quantitative assessment of the costs and benefits of each. Where administrative burdens and compliance costs on the side of the industry could be significant, EIOPA should where possible quantify these costs.

The analysis of costs and benefits is undertaken according to an Impact Assessment methodology.

The draft technical advice and its impact assessment have been subject to public consultation between 4 July and 3 October 2016. Stakeholders' responses to the public consultation were duly analysed and served as a valuable input for the revision of the draft technical advice and its impact assessment. Additionally, the opinion from the Insurance and Reinsurance Stakeholder Group, provided in Article 37 of EIOPA Regulation, has been considered.

As part of the public consultation, stakeholders were specifically requested to provide their views on the estimated costs and benefits of the proposals included in the draft technical advice in general, as well as, in particular, the estimated costs for manufacturers and distributors of the proposals regarding POG. 65 responses were received on this respect. The main messages from stakeholders can be summarised as follows:

- Costs of implementation of IDD are expected to be substantial;
- A quantification of the costs is very difficult;
- Main costs include, among others, costs in term of information provision and recording at the point of sales, compliance costs (including eventual outsourcing), training, adaptation of IT system, etc.

Although the majority of responses refer indistinctly to costs from the proposed technical advice and costs from the requirements already in IDD, EIOPA has considered all comments received to improve this impact assessment. In particular, EIOPA acknowledges the stakeholders' concerns regarding any additional costs.

The comments received and EIOPA's responses to them are summarised in the section Feedback Statement (see Final Report).

Baseline scenario

When analysing the impact from proposed policies, the Impact Assessment methodology foresees that a baseline scenario is applied as the basis for comparing policy options. This helps to identify the incremental impact of each policy option considered. The aim of the baseline scenario is to explain how the current situation would evolve without additional regulatory intervention.

EIOPA has applied as a baseline scenario to assess the potential costs and benefits from the provisions in the technical advice, the IDD requirements. This impact assessment report is not intended to analyse the costs and benefits arising from the requirements already established in the IDD. Such costs and benefits were duly analysed by the Commission and documented in the impact assessment report accompanying the text of the Directive⁴⁰.

⁴⁰ See link: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52012SC0191>

A. Product Oversight & Governance

With respect to the technical advice on product oversight and governance, EIOPA has also taken into account all the relevant input provided by stakeholders during the policy development process of EIOPA Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and insurance distributors⁴¹. A first public consultation of the draft Guidelines and their impact assessment took place between 27 October 2014 and 23 January 2015 and a second public consultation between 30 October 2015 and 29 January 2016. Additionally, in accordance with Article 16, EIOPA Regulation, the Insurance and Reinsurance Stakeholder Group was consulted and provided a formal Opinion.

A.1 – Problem definition

Article 25, IDD introduces product oversight and governance requirements for insurance manufacturers and distributors, to mitigate the risk of customer detriment from unsuitable and/or poorly designed products.

As this matter is being addressed by ESMA and EBA⁴², there is also potential for the coexistence of different regulatory/supervisory approaches in the three financial sectors.

Baseline scenario.

With respect to Product Oversight and Governance, EIOPA has applied the IDD requirements in Article 25 and the EIOPA Preparatory Guidelines on product oversight and governance arrangements for insurance undertakings and insurance distributors, as a baseline scenario in order to assess the potential costs and benefits from the provisions in the technical advice.

A.2 – Objectives

The objectives of the technical advice are:

- Objective 1: to specify the product oversight and governance principles and ensure that manufacturers and distributors of insurance products comply with those principles.
- Objective 2: to identify product manufacturer and distributor responsibilities in a proportionate manner, taking into account the nature of the product and service provided.

⁴¹ <https://eiopa.europa.eu/Publications/Reports/Final%20report%20on%20POG%20Guidelines.pdf>

⁴² Regarding the work done in respect of the other sectors of the market:

- Directive 2014/65/EU (MIFID II) includes product oversight and governance requirements for investment firms. On 25th April 2016 the Commission has adopted a delegated regulation supplementing MiFID II, which includes product governance provisions.

- On 22nd March 2016, the EBA approved product oversight and governance guidelines for retail banking products.

- Objective 3: to enhance cross-sectoral consistency with product oversight and governance arrangements for credit institutions and investment firms, to prevent regulatory arbitrage.

These objectives are consistent with the IDD aim of providing a consistent level of policyholder protection.

A.3 – Policy options

With the intention to meet the objectives set out in the previous section, EIOPA has analysed different policy options throughout the policy development process.

Taking into account that the technical advice contains several proposals based on the policy work developed by EIOPA for the development of the Preparatory Guidelines, part of the policy issues identified during the drafting process of the guidelines are deemed to be relevant for this impact assessment. Those policy issues are:

- The principle of proportionality;
- Product testing;
- Frequency of the review process for the product oversight and governance arrangements;
- Outsourcing of product design;
- Exchange of information between manufacturers and distributors; and
- Documentation of product oversight and governance arrangements.

For the sake of completeness and transparency, the analysis of the different options considered for those policy issues has also been included in this impact assessment.

During the drafting process of the technical advice the following policy issues were identified:

- The definition of insurance intermediary acting as manufacturer;
- The relationship between and respective responsibilities of the insurance undertaking and the intermediary when acting as a manufacturer;
- The identification of the target market; and
- The frequency of the review process for products.

Policy issue 1: Principle of proportionality

The impact of POG requirements will differ depending on the size (level of the undertaking), on their type of business (product level) and also depending on the risks inherent in the product. Insurance products are quite heterogeneous, in particular their complexity varies (example: general liability insurance vs. with-profit life insurance). Thus, the question arose whether regulation should be more prescriptive and differentiate between insurance business classes or whether it would be sufficient to apply the principle of proportionality more generally. A further option would be to further develop and complement the approach above by some guidance

regarding what the applicability of the principle of proportionality could mean in relation to insurance business classes. The following options were considered:

- **Option 1.1** – specific requirements by line of business: to differentiate between insurance business classes within the product oversight and governance provisions.
- **Option 1.2** – general application of the principle: not to differentiate between insurance business classes, but to take account of the applicability of the principle of proportionality in general.
- **Option 1.3** – specific guidance on application of the principle: not to differentiate between insurance business classes, but to give supervisors and insurance undertakings some guidance on details of applicability of the principle of proportionality for product and governance processes.

Policy issue 2: Need for including requirements for product testing

Product governance requirements stipulate that manufacturers should define a target market and make sure that the product is aligned with the interests, objectives and characteristics of the target market.

In order to comply with this requirement, it is important that the manufacturer tests the product thoroughly before they are brought to the target market. The conditions and methods applied for product testing, including scenario analysis, where relevant, are the responsibility of the manufacturer. It can be argued that these conditions and methods differ depending on the type of product that will be manufactured or reviewed and on the risks that the product bears for customers. Product testing may include qualitative and, where appropriate, quantitative testing or scenario analyses in order to properly assess whether the product is in line with the interests, objectives and characteristics of the target market.

Various options were examined:

- **Option 2.1** - no requirement: not to require product testing for any insurance product.
- **Option 2.2** - requirement for insurance-based investment products (IBIPs): to only require product testing for IBIPs.
- **Option 2.3** - requirement for all products: to require product testing for life and non-life insurance products.

Policy issue 3: Need for a specific provision on outsourcing of product design

The manufacturer may outsource different tasks and processes – in particular, the design of products - to third parties. This organisational choice does not mean that the manufacturer can outsource his responsibility for the outcome or for applying the relevant requirements for the outsourced process. The following options were considered:

- **Option 3.1** - specific provision: provision meaning that when product design is being outsourced, the manufacturer stays ultimately responsible regardless of the outsourcing
- **Option 3.2** – do nothing: meaning that the responsibility for applying the requirements is not especially described in case of outsourcing.

Policy issue 4: Need to strengthen the exchange of information between manufacturers and distributors of insurance products

The increasing complexity and variety of insurance products pose new challenges to insurance distributors selling insurance products manufactured by third parties. To a large extent, distributors rely on the product information provided by the manufacturers of insurance products. However, the supervisory practice has proven that distributors do not always obtain all relevant information in order which is necessary to fully understand the product characteristics and the group of customers for which the products are designed for. In order to address this issue, the following options were considered:

- **Option 4.1** – do nothing: not to specify the general requirement that the manufacturer provides all appropriate information on the product to the distributor.
- **Option 4.2** - list of information to be exchanged: to specify the information on the product and on the distribution of the product which the manufacturer and distributor should exchange.

Policy issue 5: Documentation of product oversight and governance arrangements

From an internal governance and supervisory point of view, it is important that all relevant actions taken by manufacturers and distributors in relation to the product oversight and governance arrangements are duly documented. The following policy options were considered in this regard:

- **Option 5.1** - for manufacturers and distributors: to require manufacturers and distributors to document all relevant actions in relation to the product oversight and governance arrangements and product distribution arrangements, respectively.
- **Option 5.2** – for manufacturers: to require manufacturers only to document all relevant actions in relation to the product oversight and governance arrangements, but not distributors.
- **Option 5.3** – do nothing: not to require manufacturers and distributors to document all relevant actions in relation to the product oversight and governance arrangements and product distribution arrangements.

Policy issue 6: Insurance intermediary acting as a manufacturer of insurance products

Article 25(1), IDD applies certain product governance requirements to "*insurance undertakings, as well intermediaries which manufacture any insurance product for sale to customers*". The IDD is silent on when insurance intermediaries should be considered "manufacturers" and there is no definition of "manufacturing". It is therefore useful to consider the circumstances under which an intermediary may also be acting as a manufacturer.

The following options were considered:

- **Option 6.1** – Cumulative conditions: identification of a cumulative list of conditions where an insurance intermediary could also be considered a manufacturer.
- **Option 6.2** – General criteria: identification of general criteria where an insurance intermediary could be considered a manufacturer and circumstances where an intermediary would be likely, and would not be likely, to be considered a manufacturer.

Policy issue 7: Target market

Product oversight and governance requirements set out systems and controls which firms must put in place to design, approve, market and manage products throughout their lifecycle to ensure they meet the needs, objectives and characteristics of a defined target market. These processes help to mitigate mis-selling. The identification of the target market is an important component of the POG arrangements.

Insurance products are varied in nature, ranging, for example, from simple products, compulsory products such as motor insurance, through to complex IBIPs. The policy issue centres on identifying how best to address the question of target market granularity level while maintaining firm responsibility and discretion over product manufacturing.

The following options were considered:

- **Option 7.1** - No principles to identify the target market: One option would be to introduce no principles to identify the target market for products and allow manufacturing and distribution on a broader, more generic basis.
- **Option 7.2** – High-level principles to identify the target market: Another possibility would be to adopt high-level principles to identify the target market. This means it would be possible to emphasise that the target market can differ depending on the type of product being developed.
- **Option 7.3** – Detailed requirements to identify the target market: Another possibility would be to enforce detailed requirements and describe requirements per category of products. A mandatory target market could be based on specified criteria e.g. financial situation, age, experience etc.

Policy Issue 8: Frequency of review process

Any internal process should be reviewed periodically in order to assess the permanence of the attitude and capability to reach the objectives. In light of this, the product and arrangements established by manufacturers on product oversight and governance should both be reviewed to ensure that they are still valid and up to date and amended where appropriate. Furthermore, the distributor's distribution arrangements should also be reviewed and amended where appropriate.

Regarding the frequency of the review process three options were examined:

- **Option 8.1** - Annual review: Article 41, Solvency II Directive requires insurance undertakings to review written policies on an annual basis. An annual review of product governance arrangements would be in line with this.
- **Option 8.2** - At least, review every three years.
- **Option 8.3** - No pre-determined frequency of review.

A.4 – Analysis of impacts

Policy issue 1: Proportionality principle and differentiation between insurance classes of business

Summary of options considered:

Option 1.1: to differentiate between insurance business classes within the POG requirements.

Benefits:

- For customers: minimized risk of mis-selling due to detailed rules considering all eventualities (incl. specificities of insurance business classes).

Costs:

- For NCAs and industry: among the three options considered, the highest implementation costs due to most detailed requirements. Too prescriptive provisions could also become an obstacle for product innovation.

Option 1.2: not to differentiate between insurance business classes within the POG requirements, taking account of the applicability of the principle of proportionality in general.

Benefits:

- For customers: minimum risk of mis-selling due to clear rules on product oversight and governance.

Costs:

- For NCAs and industry: implementation costs; considered the lowest among the three options compared.

Option 1.3: not to differentiate between insurance business classes within the POG requirements but to give supervisors and insurance undertakings

some guidance on details of applicability of the principle of proportionality for product and governance processes.

Benefits:

- For customers: minimized risk of mis-selling due to detailed rules considering all eventualities (incl. specificities of insurance business classes).
- For NCAs: compared to Option 1, higher level of flexibility.

Costs:

- For NCAs and industry: among the three options compared; the second highest implementation costs.
- For EIOPA: potential for the evolution of diverging supervisory practices.

Policy issue 2: Need for including requirements for product testing

Various options were examined:

Option 2.1: Not to require product testing for any insurance product.

Benefits:

- For industry: out of the options compared, the lowest or no implementation costs.
- For customers: potentially more options/product variants to choose from.

Costs:

- For industry: there is a risk that the product will not at all times fulfil the identified needs of the target market. This may harm the trust customers have in the insurance undertaking or insurance intermediary.
- For customers: out of all options compared, the highest risk of detriment occurs, as the product's design may not be entirely suitable for the customer. At a certain moment in time, the product can be the right choice, yet the customer does not know what will happen when the circumstances change.

Option 2.2: to only require product testing for life insurance products.

Benefits:

- For industry and customers: more certainty that the life insurance product fulfil the identified need of the target market at all times. The maintenance/ rebuild of trust in undertakings and their products will benefit both undertakings and customers.

Costs:

- For customers: risk of potential detriment in the case of non-life products.
- For industry: higher implementation costs than under Option 4.1. Product

testing may also hinder innovation as it can prove to be time consuming and may delay the development and issuance of new insurance products.

Option 2.3: to require product testing for both life and non-life insurance products.

Benefits:

- For industry and customers: out of all options compared, the highest certainty that any insurance product (incl. non-life) will fulfil the identified need of the target market at all times. The maintenance/rebuilding of trust in financial institutions and their products will benefit both financial institutions and their customers.

Costs:

- In general, more requirements lead to higher costs. Product testing may also hinder innovation as it can prove to be time consuming and may delay the development and issuance of new insurance products.

Policy issue 3: Need for a specific provision on outsourcing of product design

The following options were considered:

Option 3.1: specific provision when product design is being outsourced; meaning that the manufacturer remains ultimately responsible, regardless of the outsourcing.

Benefits:

- For customers: Customer protection is ultimately assured, regardless of the governmental structure and the internal decisions taken by the manufacturer on how to organise the designing of its products.
- For industry: The manufacturer faces no reputational risk in the case that the product design is being outsourced and that the arrangements on POG are not applied at the third party service provider level. The manufacturer keeps the ultimate responsibility, meaning he has the right to continuously monitor and therefore can ensure that the products offered comply with all arrangements requested. The manufacturer has the possibility to request in its contract with the third party service provider that the POG requirements are part of their contract.
- For national competent authorities (NCAs): When supervising the manufacturer, the supervisory authority concerned has one point of contact, the manufacturer and not unknown third parties like the service provider. It is assumed that the supervisor is engaging in several dialogues with the insurance undertaking, i.e. due to Solvency II requirements, and therefore already has a good understanding of the manufacturer and its governmental structures.
- For EIOPA: The Solvency II requirements in the system of governance

require the ultimate responsibility of the AMSB for any outsourced important function. To provide technical advice with the same underlying principle assures a better and consistent approach of customer protection throughout different areas.

Costs:

- For customers: Customers may face higher costs for insurance products. The risks are that the manufacturer who is going to outsource product design may face higher product costs himself. Those costs may be passed onto the buyer of the product, namely the customer.
- For industry: As described above, the manufacturer may face higher costs when outsourcing its product design. Secondly, the possibility could be that not all service providers want to apply the POG requirements or are not familiar with them which may lead to lower availability of possible service providers.

Option 3.2: no specific provision; meaning that the responsibility for applying the requirements is not specifically described in case of outsourcing.

Benefits:

- No particular benefits in comparison to Option 3.1 were identified, as the manufacturer remains responsible for any outsourced activities.

Costs:

- For customers: The customer could face insufficient customer protection when buying an insurance product which has not been designed by the manufacturer himself, but by a service provider. In many, if not all, cases, the customer has no knowledge of how the product has been designed. Therefore, insufficient information is provided, which does not allow the customer to make a clear choice.
- For NCAs: Outsourcing may hinder the competent authority's ability to take supervisory action if needed and deemed necessary in order to request that customers' interest are addressed by the third party service provider in the development phase of the product. Supervisory powers would be limited and the objective of enhanced customer protection could not be realised.
- For EIOPA: The system of governance under Solvency II includes requirements on outsourcing. In case of a different approach under POG regulation, no consistent approach would be ensured. This could result in an unlevel playing field from the perspective of risk-based supervision.

Policy issue 4: Need to strengthen the exchange of information between manufacturers and distributors of insurance products

Option 4.1: not to specify the general requirement that the manufacturer provides all appropriate information on the product to the distributor.

Benefits:

- For industry: allows for flexibility and discretion regarding the information which is exchanged between manufacturer and distributor.

Costs:

- For industry: if regulation does not specify the relevant information which manufacturers and distributors should exchange, the exchange of information depends highly on the willingness of the manufacturer and distributor to exchange information; this can have a negative impact on the exchange of information which is relevant for both in order to fulfil their regulatory requirements with regard to the product and customers.
- For NCAs: a possible need to specify the information to be exchanged through guidance at a later point in time.

Option 4.2: to specify the information on the product and on the distribution of the product which the manufacturer and distributor should exchange.

Benefits:

- For industry: strengthens the position of the distributor and manufacturer to ask for and obtain the information necessary to fulfil the distributor's duties towards the customer.
- For NCAs: no need to specify the information to be exchanged through further guidance at a later point of time.

Costs:

- For industry: cost of implementation and ongoing costs related to the increase of information to be exchanged between distributor and manufacturer.

Policy issue 5: Documentation of product oversight and governance arrangements

Option 5.1: to require manufacturers and distributors to document all relevant actions in relation to the product oversight and governance arrangements and product distribution arrangements, respectively.

Benefits:

- For industry: facilitates the internal monitoring and review of processes and measures taken in relation to the product oversight and governance arrangements.
- For NCAs: facilitates the supervision and the assessment of how the provisions are implemented by the undertakings.

Costs:

- For industry: additional costs following from the requirement to document all relevant actions in relation to the product oversight and

governance arrangements.

Option 5.2: to require manufacturers only to document all relevant actions in relation to the product oversight and governance arrangements, but not distributors.

Benefits:

- For industry: distributors would not bear additional costs to document all relevant actions in relation to the product oversight and governance arrangements; this would be for the benefit of small distributors which would potentially suffer more than large undertakings.

Costs:

- In general: would create unlevelled playing field and regulatory arbitrage between distributors and manufacturers.

Option 5.3: not to require manufacturers and distributors to document all relevant actions in relation to the product oversight and governance arrangements and product distribution arrangements.

Benefits:

- For industry: no additional costs to document all relevant actions in relation to the product oversight and governance arrangements.

Costs:

- For industry: will make it more difficult for undertakings to monitor and review actions taken in relation to the product oversight and governance arrangements.
- For NCAs: will make it more difficult for NCAs to supervise and assess the implementation of the provisions by the undertakings.

Policy issue 6: Intermediary acting as manufacturer of insurance products

Option 6.1: - Cumulative conditions

Benefits:

- For industry: industry would be provided with specific circumstances when they may or may not be considered to be manufacturers. This could also, however, restrict innovation.

Costs:

- For customers: a restrictive approach could result in circumstances where an intermediary is involved in the manufacturing process, but this is not captured in the list. This could mean the intermediary does not put in place, product governance arrangements they would otherwise have put in place, had they been considered the product manufacturer.

Option 6.2: - General criteria

Benefits:

- For customers: general criteria to identify a manufacturing function could allow for local conditions to be taken into account
- For industry: Since the general criteria are complemented with the identification of activities which are likely, and which are not likely, to be considered as activities of manufacturing, uncertainty for insurance intermediaries is limited.

Policy issue 7: Target market

Option 7.1: - No principles to identify the target market

Benefits:

- For industry and customers: Greater scope for product innovation due to wider market provisions.
- For industry: Manufacturers have full discretion and responsibility over product manufacturing.

Costs

- For industry: when there are no principles to identify the target market, this could lead to legal uncertainty for manufacturers. They may not know if they meet the IDD requirements to identify a target market.
- For customers and in general: Greater risk of miss-selling. Could undermine the aim of the product governance requirements which are intended to ensure products meet the needs and characteristics of the target market. If these are not the relevant characteristics in a particular context then it is unlikely they will be helpful and could even drive the development of product which runs counter to customer interest and limits innovation.
- For NCAs: If there are no principles to identify the target market, it could be difficult and costly to supervise the IDD requirements.

Option 7.2: – High level principles to identify the target market

Benefits

- For customers, industry and in general: high-level principles may help industry to identify the needs and characteristics of the target market more clearly and manufacture products which are in line with the specifications of the target market. This would likely lead to a reduction in mis-selling and provide industry with discretion to innovate when manufacturing insurance products.
- For NCAs: High level principles would provide NCAs with the legal basis to act if products run counter to customer interest.

Costs

- For customer and industry: High level principles could potentially lead to more implementation costs than no principles at all. This could result in increased product costs for the customer.

Option 7.3: – Detailed requirements to identify the target market

Benefits

- For industry: Detailed regulation will provide (legal) certainty to manufacturers.

Costs

- For industry and customers: Detailed regulation would likely result in higher implementation costs which may be passed on to the customer through higher product prices. Furthermore, prescriptive regulation would reduce manufacturer discretion and responsibility. It could also limit product innovation and the manufacturer's ability to respond to changing circumstances that could benefit customers.
- It might also be disadvantageous for smaller firms because they would be less likely to absorb the costs.
- For NCAs: Prescriptive legislation could reduce NCAs' ability to act if detailed requirements are fulfilled but the product produced is not in line with the interest of customers. It would also reduce NCA options to organise their assessments more efficiently and effectively. This could lead to higher supervision costs.

Policy issue 8: Frequency of the review

Option 8.1: - At least annual review

Benefits:

- For customers: Alignment with Solvency II review requirements would deliver a consistent approach for customers.
- For industry: Alignment with the Solvency II review provisions could enable firms to develop efficiencies and consistency of approach.

Costs:

- For industry: Annual reviews of POG arrangements may be costly for smaller manufacturers or distributors which also play a role in manufacturing where the product offering does not change on a yearly basis.

Option 8.2: - At least, review every three years

Benefits:

- For industry and in general: Certainty about the minimum frequency of the review without imposing an annual review, which may be too costly

(in particular for small manufacturers).

- For customers: Reduce the risk of customer detriment by avoiding that a review would not take place as often as necessarily.

Costs:

- For industry and general: Not alignment with the annual review of written policies in Solvency II.

Option 8.3: – No uniform pre-determined frequency

Benefits:

- For customers: Manufacturers could undertake POG reviews more frequently if no specific timeframe is imposed. This could be appropriate for new products introduced throughout the year.
- For industry: The manufacturer would have discretion over the most relevant and appropriate timing based on the product offering and risk profile.

Costs:

For industry and in general: POG reviews which are not aligned to the Solvency II annual governance review requirement could result in an inconsistent approach which could potentially lead to additional costs for the firm.

A.5 – Comparison of options

Policy issue 1: Proportionality principle and differentiation between insurance classes of business

When comparing the costs and benefits of the different options, it became apparent that the anticipated benefits would be largely similar in all cases. Based on the assessment of costs, Option 1.2 seemed preferable. Besides, the criteria for the proportionality principle as well as for its application are being referred to in the IDD⁴³ and the Solvency II Directive⁴⁴.

Taking this into consideration, **option 1.2 (not to differentiate between insurance business classes, taking account of the applicability of the principle of proportionality in general)** was chosen. It points out that the principle of proportionality does not mean only to ensure a proportionate application of the requirements in order to limit burden on small size manufacturers/distributors, but also to avoid too burdensome processes for insurance business classes with lower risk and/or complexity.

An explicit reference has been inserted in the proposed technical advice to clarify that product oversight and governance arrangements and product distribution

⁴³ Article 25 (1) IDD: "The product approval process shall be proportionate and appropriate to the nature of the product."

⁴⁴ Article 29 (3) Solvency II: "Member States shall ensure that the requirements laid down in this Directive are applied in a manner which is proportionate to the nature, scale and complexity of the risks inherent in the business of an insurance or reinsurance undertaking."

arrangements need to be proportionate to the level of complexity and the risks related to the products as well as the nature, scale and complexity of the relevant business of the insurance distributor.

Policy issue 2: Need for including requirements for product testing

A quantitative test can be run in order to see whether risk and return are well balanced under different scenarios for unit-linked investments. For non-life insurance, the coverage of the product can be looked at, for instance, to see under what conditions, or in which "scenarios", an overlap with other products occur. Based on this analysis, the manufacturer can align the coverage of the product with the other products he offers in order to prevent or reduce overlap in coverage.

Scenario analysis should therefore be seen in a broader context, and should be considered as a useful method in order to make sure that the product is aligned with the interests, objectives and characteristics of the target market during the life cycle of the product. Due to the fact that the technical advice capture all types of insurance products, it was decided that **option 2.3 (to require product testing for life and non-life insurance products)** is the most appropriate level of requirement.

Policy issue 3: Need for a specific provision on outsourcing of product design

In the system of governance requirements under Solvency II, the insurance undertaking remains ultimately responsible when outsourcing important tasks or key functions. EIOPA deems this principle to be one of the most important for good governance. Cases in the market where this rule has not been applied can serve as examples of failures not only in governance and therefore as failures for the insurance undertaking, but even serve as examples of very poor customer protection.

It was concluded that in order to ensure that the product design complies with and serves the overall objective of this technical advice to enhance customer protection - even in those cases where the manufacturer has chosen to outsource this tasks -, a specific provision in the technical advice was needed. Hence **option 3.1 (specific provision when product design is being outsourced)** is the preferred option. This option does not prevent the manufacturer from organising his internal processes to best fit his business and to avoid customer detriment at the same time.

Policy issue 4: Need to strengthen the exchange of information between manufacturers and distributors of insurance products

As outlined in the presentation of policy issue 4, the supervisory practice has shown that distributors do not always receive all relevant information, which is necessary to fully understand the products they intend to distribute. Deficits in information may impede the proper assessment and thorough understanding of insurance products, as well as negatively affect the quality of services provided to the customer, eventually leading to poor quality of services and raising the risk of customer detriment.

Strengthening the exchange of information on the product between manufacturer and distributor seems the appropriate way of overcoming this risk. Against this background, **option 4.2 (to specify the information on the product and on the distribution of the product which the manufacturer and distributor should exchange)** is the preferred option.

Policy issue 5: Documentation of product oversight and governance arrangements and product distribution arrangements

As outlined in the presentation of policy issue 5, it is important from an internal governance and supervisory point of view, to duly document all relevant actions in relation to the product oversight and governance arrangements. For insurance distributors, an appropriate documentation facilitates the compliance, internal monitoring and review of processes and measures taken in relation to product oversight and governance arrangements.

For national competent authorities, a proper documentation facilitates the supervision of implementation. This does not only apply with regard to manufacturers, but also for distributors. Therefore, a distinction between manufacturers on one side and distributors on the other side does not seem appropriate. Against this background **option 5.1 (to require manufacturers and distributors to document all relevant actions in relation to the product oversight and governance arrangements and product distribution arrangements, respectively)** is the preferred option. In order to limit this requirement, it has been specified that the documentation should be kept for a minimum period of five years (which is in line with the approach taken by MiFID I and MiFID II).

Policy issue 6: Intermediary acting as product manufacturer

Intermediaries should be considered manufacturers where they have a decision-making role in product design and development. Distribution strategies across Member States vary, which means it can be challenging to identify specific circumstances where the intermediary is involved in product manufacturing.

According to this, **option 6.2 (general criteria)** was followed. Non-exhaustive criteria can be used to determine the intermediary's role as manufacturer on a case-by-case basis. This should be based on an overall analysis of the specific activities of the insurance intermediary in the product design.

Policy issue 7: Target market

EIOPA's preferred policy option is **option 7.2 (high-level principles to identify the target market)**. High level principles support the aim of the POG arrangements to produce insurance products which are in line with the interest and characteristics of the target market. It will give more legal certainty for the industry, but will also leave discretion and responsibility with the manufacturer. Furthermore, it will give NCAs a legal basis to challenge products, which do not meet customer interests.

Policy issue 8: Frequency of the review

The benefit of option 8.1 (annual review) is that it provides consistency with Solvency II, which requires insurance firms to annually review governance arrangements. EIOPA considered an annual review to be too costly particularly for small undertakings or to those that do not frequently design new products. On the other hand, an annual review could be seen as not sufficiently effective for larger insurance undertakings or for those that frequently design new product lines.

Bearing these concerns in mind, **option 8.3 (no frequency requirements)** was followed. The technical advice does not specify the frequency of the process, leaving such decisions to the manufacturer. This option allows each manufacturer to adapt the frequency of the review process in line with the timing of the internal design product, also taking into account the size, scale and complexity of the insurance undertaking and of the different products that it manufactures.

B. Conflicts of Interest

B.1 – Problem definition

Articles 27 and 28, IDD comprise new organisational requirements for insurance undertakings and insurance intermediaries with regard to conflicts of interest that arise in the context of the distribution of insurance-based investment products.

Article 27 requires insurance undertakings and insurance intermediaries to take all reasonable steps to prevent conflicts of interest from adversely affecting the interests of their customers.

Article 28(1) requires insurance undertakings and insurance intermediaries to identify and manage conflicts of interest that arise in the course of carrying out insurance distribution activities.

Article 28(4) empowers the Commission to adopt delegated acts to further define the steps insurance undertakings and insurance intermediaries have to take to identify, prevent, manage and disclose conflicts of interest, as well as to establish criteria for determining the types of conflict of interest that may damage the interests of the customer.

An equivalent set of rules for investment firms providing investment services in financial instruments has already been introduced through the Directive 2006/73/EC implementing Directive 2004/39/EC of the European Parliament and of the Council as regards the organisational requirements and operating conditions for investment firms (hereafter “MiFID Implementing Directive”) and are now embodied in a Delegated Regulation under MiFID II, which has recently been adopted by the Commission⁴⁵.

The underlying rationale of Articles 27 and 28, IDD is that insurance-based investment products are often made available to customers as potential alternatives or substitutes to financial instruments (Recital 56, IDD). In order to provide consistent protection for customers and ensure a level playing field between similar products, it is important that the distribution of insurance-based investment products is subject to comparable regulatory requirements. Therefore, the objective pursued by the European legislator is to address the issue of an uneven playing field across the different financial sectors hindering fair competition in the market, as well as to abolish regulatory inconsistencies leading to a patchwork of consumer protection.

Articles 27 and 28, however, neither specify which criteria should be applied for the identification of conflicts of interest that may arise with regard to the distribution activities of insurance undertakings and insurance intermediaries, nor stipulate organisational measures to be considered for the management of conflicts of interest identified by insurance undertakings and insurance intermediaries.

Different from the regulatory regime under MiFID II as circumscribed above, the provisions in IDD, due to their abstract wording, would leave a broad discretion to National Competent Authorities (NCAs) and regulated entities as to how these

⁴⁵ Commission Delegated Regulation supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

requirements are applied in practice. This would result in a divergent implementation and application contrary to the objective to foster a level playing field.

In order to avoid regulatory arbitrage and to contribute to a homogenous application of the new organisational requirements for insurance undertakings and insurance intermediaries it is therefore necessary to specify these requirements through implementing measures.

As the data provided by stakeholders in response to the EIOPA's Consultation Paper on Conflicts of Interest is not sufficiently representative to allow a reliable assessment of the quantitative impacts, the following analysis will focus on the qualitative impacts following from the Technical Advice.

With respect to studies mandated by the Commission, which have addressed the question of how the application of the rules of conduct and the organisational requirements of MiFID would impact the insurance sector the following analyses are of particular importance:

- Impact Assessment accompanying the Commission's Proposal to recast the Directive on Markets in Financial Instruments (published on 20 October 2011): http://ec.europa.eu/internal_market/securities/docs/isd/mifid/SEC_2011_1226_en.pdf
- Study on the Costs and Benefits of Potential Changes to Distribution Rules for Insurance Investment Products and other Non-MiFID Packaged Retail Investment Products (published on 29 October 2010): http://ec.europa.eu/internal_market/consultations/docs/2010/prips/costs_benefits_study_en.pdf
- Impact Assessment accompanying the Commission's Proposal to recast the Directive on Insurance Mediation: http://ec.europa.eu/finance/insurance/docs/consumers/mediation/20120703-impact-assessment_en.pdf

Baseline scenario

With respect to conflicts of interest, EIOPA has applied as a baseline scenario to assess the potential costs and benefits from the provisions in the technical advice, the IDD requirements in Articles 27 and 28 applicable to insurance undertakings and insurance distributors.

B.2 – Objectives

The empowerment of the Commission to adopt delegated acts to specify the organisational measures insurance undertakings and insurance intermediaries should take in order to identify and manage conflicts of interests was introduced in the IDD which provided for general rules of conduct in relation to insurance-based investment products.

The Recitals of the IDD indicate that the objectives of the legislator are to deliver consistent protection for retail customers and to ensure a level playing field between similar products. Against this background, the objectives of the Technical Advice are:

- to enhance consumer protection through provisions addressing conflicts of interest arising in the context of the distribution of insurance-based investment products and potentially creating the risk of consumer detriment.
- to encourage consistent application of the organisational measures insurance undertakings and insurance intermediaries should take to manage conflicts of interest that arise in the course of carrying out distribution activities in insurance-based investment products;
- to foster a level playing field regarding the distribution of financial products, which compete with each other and are substitutable from a consumer point of view;

B.3 – Policy options

With the intention to meet the objectives set out in the previous section, EIOPA has analysed different policy options throughout the policy development process. In particular, EIOPA has analysed different policy options with respect to:

- criteria for the identification of conflicts of interest; and
- steps to manage conflicts of interest.

Policy Issue 1: Criteria for the identification of conflicts of interest

With regard to the Commission's request to establish appropriate criteria for the identification of conflicts of interest EIOPA has considered the following options:

- **Option 1.1** - Criteria in MIFID II Delegated Regulation

To implement Article 33 of the MiFID II Delegated Regulation defining the criteria regulated entities are required to apply for the identification of conflicts of interest.

Article 33 of the draft Delegated Regulation under MiFID II reads as follows:

"For the purposes of identifying the types of conflict of interest that arise in the course of providing investment and ancillary services or a combination thereof and whose existence may damage the interests of a client, investment firms take into account, by way of minimum criteria, the question of whether the investment firm or a relevant person, or a person directly or indirectly linked by control to the firm, is in any of the following situations, whether as a result of providing investment or ancillary services or investment activities or otherwise:

(a) the firm or that person is likely to make a financial gain, or avoid a financial loss, at the expense of the client;

(b) the firm or that person has an interest in the outcome of a service provided to the client or of a transaction carried out on behalf of the client, which is distinct from the client's interest in that outcome;

(c) the firm or that person has a financial or other incentive to favour the interest of another client or group of clients over the interests of the client;

(d) the firm or that person carries on the same business as the client;

(e) the firm or that person receives or will receive from a person other than the client an inducement in relation to a service provided to the client, in the form of monies, goods or services, other than the standard commission or fee for that service."

- **Option 1.2** - Criteria in MIFID II with amendments

To modify Article 33 of the MiFID II Delegated Regulation in order to mirror two additional instances where EIOPA believes that conflicts of interest may arise: In contrast and in addition to Option 1.1, this Option would classify third-party payments as well as the involvement of the insurance distributor in the product development as typical instances where conflicts of interest may arise.

This Policy Option reads as follows:

"For the purpose of identifying the types of conflict of interest that arise in the course of carrying out any insurance distribution activities related to insurance-based investment products and which entail the risk of damage to the interests of a customer, insurance intermediaries and insurance undertakings shall assess whether they, including their managers, employees or any person directly or indirectly linked to them by control, have an interest related to the insurance distribution activities which is distinct from the customer's interest and which has the potential to influence the outcome of the services at the detriment of the customer. Insurance intermediaries and undertakings shall also identify conflicts of interest between one customer and another.

For the purpose of identifying conflicts of interests as outlined in paragraph 1, insurance intermediaries and insurance undertakings shall take into account, by way of minimum criteria, any of the following situations:

a. the insurance intermediary, insurance undertaking, including their managers, employees or any person directly or indirectly linked to them by control is likely to make a financial gain, or avoid a financial loss, to the detriment of the customer;

b. the insurance intermediary, insurance undertaking, including their managers, employees or any person directly or indirectly linked to them by control has a financial or other incentive to favour the interest of another customer or group of customers over the interests of the customer;

c. the insurance intermediary, insurance undertaking, including their managers, employees or any person directly or indirectly linked to them by control receives or will receive from a person other than the customer a monetary or non-monetary benefit in relation to the insurance distribution activities provided to the customer.

d. the insurance intermediary, persons working in an insurance undertaking responsible for the distribution of insurance-based investment products or linked person are substantially involved in the management or development of the insurance-based investment products, in particular if they have an influence on the pricing of those products or its distribution costs."

Policy Issue 2: Steps to manage conflicts of interest

With regard to the Commission's request to define steps insurance undertakings and insurance intermediaries should take to manage conflicts of interest.

With regard to Commission's request to specify the organisational measures insurance undertakings and insurance intermediaries should take in order to manage conflicts of interest EIOPA has considered the following options:

- **Option 2.1** - General principle in MIFID II

Only to introduce the general principle of Article 34 of the MiFID II Delegated Regulation, obliging insurance undertakings and insurance intermediaries to establish an effective conflicts of interest policy in writing in order to ensure that the relevant activities are provided at an appropriate level of independence without specifying concrete organisational measures undertakings should consider for that purpose.

- **Option 2.2** - General principle combined with concrete organisational measures

To introduce the general principle of Article 34 of the MiFID II Delegated Regulation combined with specific organisational measures and procedures, insurance undertakings and insurance intermediaries should take to manage conflicts of interest (e.g. effective procedure to prevent or control the exchange of information).

Article 34 of the MiFID II Delegated Regulation reads as follows (wording would have to be aligned to the insurance vocabulary, e.g. "client" has been replaced by "customer"):

"1. Investment firms shall establish, implement and maintain an effective conflicts of interest policy set out in writing and appropriate to the size and organisation of the firm and the nature, scale and complexity of its business.

Where the firm is a member of a group, the policy must also take into account any circumstances, of which the firm is or should be aware, which may give rise to a conflict of interest arising as a result of the structure and business activities of other members of the group.

2. The conflicts of interest policy established in accordance with paragraph 1 shall include the following content:

(a) it must identify, with reference to the specific investment services and activities and ancillary services carried out by or on behalf of the investment firm, the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests of one or more clients;

(b) it must specify procedures to be followed and measures to be adopted in order to manage such conflicts.

3. The procedures and measures referred to in paragraph 2(b) are designed to ensure that relevant persons engaged in different business activities involving a conflict of interest of the kind specified in paragraph 2(a) carry on those activities at a level of independence appropriate to the size and activities of the investment firm and of the group to which it belongs, and to the risk of damage to the interests of clients.

For the purposes of paragraph 2(b), the procedures to be followed and measures to be adopted shall include such of the following as are necessary and appropriate for the firm to ensure the requisite degree of independence:

(a) effective procedures to prevent or control the exchange of information between relevant persons engaged in activities involving a risk of a conflict of interest where the exchange of that information may harm the interests of one or more clients;

(b) the separate supervision of relevant persons whose principal functions involve carrying out activities on behalf of, or providing services to, clients whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the firm;

(c) the removal of any direct link between the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated by, different relevant persons principally engaged in another activity, where a conflict of interest may arise in relation to those activities;

(d) measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out investment or ancillary services or activities;

(e) measures to prevent or control the simultaneous or sequential involvement of a relevant person in separate investment or ancillary services or activities where such involvement may impair the proper management of conflicts of interest.

4. Investment firms shall ensure that disclosure to clients, pursuant to Article 23(2) of Directive 2014/65/EU, is a measure of last resort that shall be used only where the effective organisational and administrative arrangements established by the investment firm to prevent or manage its conflicts of interest in accordance with Article 23 of Directive 2014/65/EU are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of the client will be prevented.

The disclosure shall clearly state that the organisational and administrative arrangements established by the investment firm to prevent or manage that conflict are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests of the client will be prevented. The disclosure shall include specific description of the conflicts of interest that arise in the provision of investment and/or ancillary services, taking into account the nature of the client to whom the disclosure is being made. The description shall explain the general nature and sources of conflicts of interest, as well as the risks to the client that arise as a result of the conflicts of interest and the steps undertaken to mitigate these risks, in sufficient detail to enable that client to take an informed decision with respect to the investment or ancillary service in the context of which the conflicts of interest arise.

5. Investment firms shall assess and periodically review, on an at least annual basis, the conflicts of interest policy established in accordance with paragraphs 1 to 4 and shall take all appropriate measures to address any deficiencies. Over-reliance on disclosure of conflicts of interest shall be considered a deficiency in the investment firm's conflicts of interest policy.

- **Option 2.3** - Alternative measures

This Option builds upon Article 34 of the MiFID II Delegated Regulation. In view of the specificities of the insurance sector, the wording of paragraph 4 has been substantially modified, allowing insurance undertakings and insurance intermediaries to demonstrate that alternative measures and procedures are appropriate to ensure that the distribution activities are carried out in accordance with the best interest of the customer and are not biased by conflicting interests.

This Policy Option reads as follows:

"1. Insurance intermediaries and insurance undertakings shall establish, implement and maintain an effective conflicts of interest policy set out in writing and appropriate to their size and organisation and the nature, scale and complexity of their business. Where the insurance intermediaries or insurance undertaking is a member of a group, the policy must also take into account any circumstances, of which the insurance intermediary or insurance undertaking is or should be aware, which may give rise to a conflict of interest arising as a result of the structure and business activities of other members of the group.

2. The conflicts of interest policy established in accordance with paragraph 1 shall include the following content:

(a) it must identify, with reference to the specific insurance distribution activities carried out, the circumstances which constitute or may give rise to a conflict of interest entailing a risk of damage to the interests of one or more customers;

(b) it must specify procedures to be followed and measures to be adopted in order to manage and prevent such conflicts from damaging the interests of the customer of the insurance intermediary or insurance undertaking, appropriate to the size and activities of the insurance intermediaries or insurance undertaking and of the group to which they belong, and to the risk of damage to the interests of customers.

3. For the purpose of paragraph 2(b), the procedures to be followed and measures to be adopted shall include, where appropriate, in order to ensure that the distribution activities are carried out in accordance with the best interest of the customer and are not biased by conflicting interests of the insurance undertaking, the insurance intermediaries or another customer, the following:

(a) effective procedures to prevent or control the exchange of information between relevant persons engaged in activities involving a risk of a conflict of interest where the exchange of that information may damage the interests of one or more customers;

(b) the separate supervision of relevant persons whose principal functions involve carrying out activities on behalf of, or providing services to, customers whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the insurance intermediary or insurance undertaking;

(c) the removal of any direct link between the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated by, different relevant persons principally engaged in another activity, where a conflict of interest may arise in relation to those activities;

(d) measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out insurance distribution activities;

(e) measures to prevent or control the simultaneous or sequential involvement of a relevant person in insurance distribution activities where such involvement may impair the proper management of conflicts of interest.

4. *If insurance intermediaries and insurance undertakings demonstrate that those measures and procedures are not appropriate to ensure that the distribution activities are carried out in accordance with the best interest of the customer and are not biased by conflicting interests of the insurance undertaking, the insurance intermediaries or another customer, insurance intermediaries and insurance undertakings must adopt adequate alternative measures and procedures for that purpose.*

5. *The measures and procedures taken by the insurance intermediaries and insurance undertakings according to [this Policy Option] are without prejudice to the specific rules on inducements, in particular the obligation to assess the detrimental impact of inducements on the quality of the relevant service to the customer.*

6. *Insurance intermediaries and insurance undertaking shall avoid over reliance on disclosure and shall ensure that disclosure, pursuant to Article 28 (2), IDD, is a step of last resort that can be used only where the effective organisational and administrative measures established by insurance intermediaries and insurance undertakings to prevent or manage conflicts of interest in accordance with Article 27, IDD are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests of the customer will be prevented.*

7. *Insurance intermediaries and insurance undertaking shall make that disclosure to customers, pursuant to Article 28(2), IDD, in a durable medium. The disclosure shall:*

(a) include a specific description of the conflict of interest, including the general nature and sources of the conflict of interest, as well as the risks to the customer that arise as a result of the conflict and the steps undertaken to mitigate these risks,

(b) to clearly state that the organisational and administrative arrangements established by the insurance intermediary or insurance undertaking are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests to the customer will be prevented, in order to enable the customer to take an informed decision with respect to the insurance distribution activities in the context of which the conflict of interest arises.

8. Insurance intermediaries and insurance undertakings shall:

(a) assess and periodically review – at least annually – the conflicts of interest policy established in accordance with this article and to take all appropriate measures to address any deficiencies, and

(b) keep and regularly update a record of the situations in which a conflict of interest entailing a risk of damage to the interests of the one or more customers has arisen or, in the case of an ongoing service or activity, may arise.

9. Where established, senior management shall receive on a frequent basis, and at least annually, written reports on these situations”.

B.4 – Analysis of impacts

As the Policy Options with regard to the Policy Issue 1 and Policy Issue 2 are closely linked and complementary to each other, it is appropriate and necessary to analyse their impacts all together. This is supported by the fact that the respective Policy Options differ only slightly and the following analysis focus on the qualitative aspects, only.

Benefits:

For insurance undertakings and insurance intermediaries, the Policy Options with regard to Policy Issues 1 and 2 as could provide the following benefits:

- Prevention of customer detriment and legal action: The Policy Proposal will lower the risk of consumer detriment resulting from an improper management of conflict of interests and consequently lower the risk that costumers take legal action because of damages suffered.
- Increased customer confidence and decreased reputational risks: As outlined, the Policy Proposal will lower the risk of consumer detriment which simultaneously increase the customer’s confidence and decrease reputational risks.
- Enhanced corporate governance: The policy proposal will enhance corporate governance mechanisms by which insurance undertakings and insurance intermediaries are supervised and directed.
- Prevention of regulatory arbitrage: Harmonised rules ensure equal treatment of entities located in different Member States (regulatory arbitrage with regards of entities of different origin) as well as alike treatment of entities distributing products different with regard to legal nature and regulation (cross sectorial regulatory arbitrage).

For customers, the Policy Options with regard to Policy Issues 1 and 2 could provide the following benefits:

- Enhanced consumer protection: The Policy Proposal aims to ensure that insurance undertakings and insurance intermediaries provide their services in the best interest of their customers and conflicts of interest are not improperly resolved, to the detriment of the customer.
- Counterbalance to the customer's paucity of information: The Policy Proposal aims to counterbalance the customer's paucity of information since customers do not generally have the full picture of the extent to which insurance undertakings and insurance intermediaries are facing conflicts of interest.

For NCAs, the Policy Options with regard to Policy Issues 1 and 2 could provide the following benefits:

- Enhanced legal certainty: Implementing measures facilitate the application and understanding of Level 1 – requirements

Costs:

For insurance undertakings and insurance intermediaries, the Policy Options with regard to Policy Issues 1 and 2 could involve the following costs:

- One-off costs as insurance undertakings and insurance intermediaries are required to take organisational and procedural measures for implementation (e.g. costs associated with project management and/or engagement with external consultants, the identification of conflicts of interest, the development or revision of conflicts of interest policies, the introduction of new IT systems, staff training).
- Ongoing costs as insurance undertakings and insurance intermediaries are required to periodically review and adapt their organisational measures and procedures, if necessary (including the periodic identification of conflicts of interest and revision of conflicts of interest policies, if necessary).

For customers, the Policy Options with regard to Policy Issues 1 and 2, could involve the following costs:

- Additional costs insurance undertakings and insurance intermediaries have to bear in order to implement the new regulatory requirements may be transferred to customers, rendering services and products more expensive.

For NCAs, the Policy Options with regard to Policy Issues 1 and 2, could involve the following costs:

- The need to supervise and enforce new rules.

B.5 – Comparison of options

• **Policy Issue 1: Criteria for the identification of conflicts of interest**

With regard to Option 1.1 (Criteria in MIFID II Delegated Regulation) and Option 1.2 (Criteria in MIFID II with amendments), EIOPA considers it generally appropriate to make recourse to Article 33 of the MiFID II Delegated Regulation and to transfer its principles in order to define appropriate criteria for the

identification of conflicts of interest that may arise in the course of carrying out insurance distribution activities.

Even though the wording in Article 33 of the MiFID II Delegated Regulation addresses investment firms only, EIOPA notes that the instances circumscribed in the provision are of a broad and abstract nature, such that they, in principle, can be applied very broadly across the different sectors of the financial services. The instances rather describe situations where conflicts of interest commonly arise when a commercial activity is pursued and the interests of customers are at stake. The interest to make a financial gain at the expense of the customer is a good example. Consequently, EIOPA considers that the principles as laid down in Article 33(a)–(e) of the MiFID II Delegated Regulation are also relevant for insurance intermediaries and insurance undertakings in the course of carrying out insurance distribution activities.

Nevertheless, EIOPA is of the opinion that Article 33 should be modified in order to address the following issues.

Firstly, a general circumscription of conflict of interest should be introduced to facilitate the understanding and application of the provision. This clarifies that the specific instances listed in letter (a) - (d) are only of exemplary nature and insurance undertakings and insurance intermediaries should focus on the general question whether they pursue interests which are distinct from the customer's interests and which have the potential to influence the services rendered at the detriment of the customer.

Secondly, it should be clarified that conflicts of interest may also arise if the distributors are substantially involved in the development or management of products. For example, conflicts of interest arise where an intermediary exercises influence over how distribution costs that benefit the intermediary are embedded in the design of a product or where an intermediary is rewarded with a percentage of the management costs.

Thirdly, it should be clarified that conflicts of interest arise whenever the insurance intermediary receives a commission or fee paid by a third party, independent from the question whether the commission or fee corresponds with the market standard or not. This follows from the intermediary's own interest to make a financial gain when providing services to the customer.

Against this background, **Option 1.2 (Criteria in MIFID II with amendments)** seems to offer the preferable solution from EIOPA's point of view.

- **Policy Issue 2: Steps to manage conflicts of interest**

Option 2.1 (general principle in MIFID II) would offer insurance undertakings and insurance intermediaries a broad discretion and flexibility how to implement the organisational requirements. In addition to that, Option 2.2 (Concrete organisational measures) would require the entities to consider whether a catalogue of proposed measures is necessary and appropriate in order to manage conflicts of interest properly and ensure the prerequisite independence. EIOPA believes that the measures of Article 34 of the MiFID II Delegated Regulation do

not only apply for investment firms, but have also a particular relevance to manage conflicts of interest arising in the context of the insurance distribution activities. For example, "measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries ... services or activities" may play a role in the relationship between a sales manager and employees advising customers with regard to insurance-based investment products.

If the entities come to the conclusion and can demonstrate that the proposed measures and procedures are not appropriate, the entities are entitled, under **Option 2.3 (alternative measures)**, to adopt alternative measures to ensure that the services provided are not biased by conflicting interests of those entities. From EIOPA's perspective, **Option 2.3** therefore offers the most appropriate solution.

C. Inducements

C.1 – Problem definition

The IDD introduces new requirements in relation to insurance-based investment products. These requirements are additional to those applying to all insurance products within scope of the IDD. Chapter VI of the IDD sets out the additional requirements, covering conflicts of interest, costs and charges, inducements, suitability, appropriateness and reporting to customers.

The IDD requirement to which this technical advice on inducements relates, is covered in Article 29(2). It obliges Member States to ensure that insurance intermediaries and undertakings are meeting their obligations under the IDD where they pay or receive any fee, commission, or other non-monetary benefit, in connection with the distribution of an insurance-based investment product or ancillary service. Article 29(2) introduces a test that the payment or benefit must: a) not have a detrimental impact on the quality of the relevant service to the customer; and b) not impair compliance with the insurance intermediary's or insurance undertaking's duty to act honestly, fairly and professionally in accordance with the best interests of its customers.

In the impact assessment accompanying the draft proposal to amend the Insurance Mediation Directive (IMD) in 2012, the Commission found that general problems with insurance products were more pronounced in the case of insurance-based investment products due to their complexity. One area identified as a heightened risk was conflicts of interest stemming from remuneration structures.

The Commission went on to state that consumer protection standards for the sales of these products were not sufficient at EU level, as these products were sold under the general IMD rules for the sales of insurance even though insurance-based investment products are very different in nature and generally represent higher risks for retail consumers.⁴⁶

The disparity between consumer protection standards under IMD and those under MiFID was considered a deficiency. While some Member States had sought to address the disparity by introducing stricter rules for these products, the vast majority (21 out of 27 Member States) had left the area unregulated. This meant that consumers in different Member States were not protected to the same extent, and there is an uneven playing field between Member States and within Member States in respect of sellers of insurance with investments and those only selling investment products.⁴⁷

The particular issue with inducements is their potential to influence the distributor's product offer or advice. As stated by the Commission, consumer harm can arise in two slightly different ways: either through a lock-in of intermediaries into quasi-exclusive dealing arrangements with a single upstream insurance company (whereby consumers

⁴⁶ Commission Staff Working Document Impact Assessment: Accompanying the document Proposal for a Directive of the European Parliament and of the Council on Insurance Mediation (SWD/2012/0191 final), *Section 3.2 Problems relating to Packaged Retail Investment Products (PRIIPs)*.

⁴⁷ IBID, *Section 3.1.2 Conflicts of interest*

turning to the intermediary will not have sufficient choice to best satisfy their needs), or through biased advice to the consumer.

On the demand-side, inducement bias can lead to customers purchasing products they do not need or want. This, in turn, can result in unnecessary costs, dissatisfaction and distrust of the industry. Given that insurance-based investment products are purchased for the purpose of building up savings, the impact of mis-purchasing can be significant, either through the customer taking on too much (or little) risk, with potential thereby for loss of savings, or through the customer being exposed to poor performance and high costs, also with a negative impact on savings.

It can also negatively impact the supply-side of the market. Biased advice or offerings may mean that providers with higher quality and lower cost products may not be receiving the returns expected because other similar products have higher inducements being made. These inducements can therefore have an impact on competition between providers. In addition, where customers are dissatisfied or distrustful, this can lead to more costs due to complaints and lower sales.

The Commission's mandate sets out the parameters for the technical advice, and therefore the scope of the policy options considered. The mandate requests advice on measures specifying the rules on fees, commissions or non-monetary benefits in connection with the distribution of insurance-based investment products laid down in Article 29(2) of the Directive:

- The criteria for assessing whether inducements paid or received by an insurance intermediary or an insurance undertaking have a detrimental impact on the quality of the relevant service to the customer
- The criteria for assessing compliance of insurance intermediaries and insurance undertakings paying or receiving inducements with the obligation to act honestly, fairly and professionally in accordance with the best interests of the customer.

The Commission further sets out matters that the measures should take into account as well as a guide to the approach (for example, that the technical advice should build on the results of previous work carried out by EIOPA and ESMA).

Baseline

With respect to inducements, EIOPA has applied as a baseline scenario to assess the potential costs and benefits from the provisions in the technical advice, the IDD requirements in Article 29 applicable to insurance undertakings and insurance distributors.

C.2 – Objectives

Taking account the Commission's mandate, the objectives of the technical advice are to:

- Enhance consumer protection and foster a level playing field by having a consistent approach to the identification and assessment of inducements at risk

of having a detrimental impact on the quality of service provided to the customer, as well as those practices which may mitigate the risks associated with an inducement.

- Encourage consistent application of organisational measures that insurance undertakings and intermediaries should have in place to ensure that inducements do not lead to a detrimental impact on the service provided to the customer or prevent the intermediary or undertaking with acting honestly, fairly and in the best interests of their customers.
- Improve market dynamics, by supporting a consistency of approach (where possible) between insurance-based investment products and products within scope of MiFID II. This should reduce risks associated with regulatory arbitrage, but also support businesses who are competing with substitutable or similar products.

C.3 – Policy options

With the intention to meet the objectives set out in the previous section, EIOPA has analysed different policy options throughout the policy development process. In particular, EIOPA has analysed different policy options with respect to:

- The need for a general principle on inducements at risk of causing a detrimental impact;
- The identification of inducements that are considered to increase the risk of having a detrimental impact;
- The identification of circumstances that may be considered to reduce the risks that inducement have a detrimental impact; and
- Organisational requirements related to inducements.

Policy Issue 1 - Inducements at risk of causing a detrimental impact: high-level principle

The IDD sets out the overarching requirement that determines whether an inducement can be paid, but is on silent on when an inducement has a detrimental impact. The Commission has requested that EIOPA provide advice on the criteria for assessing whether inducements paid or received by an insurance intermediary or an insurance undertaking in connection with the distribution of insurance-based investment products have a detrimental impact on the quality of the relevant service to the customer.

EIOPA has considered the following options to address this issue:

- **Option 1.1** - do not introduce a high-level principle
- **Option 1.2** - introduce the criterion of quality enhancement similar to Article 24(9) of MiFID II and further specified in the Commission's proposal for a delegated Directive under MiFID II requiring that an additional or higher level of service to

the client is provided, that the inducement does not directly benefit the recipient firm, and that an on-going benefit is provided to the client.

- **Option 1.3** - introduce a high-level principle based upon Article 17 IDD stating that inducements have a detrimental impact if they provide an incentive to carry out the distribution activities in a way which is not in accordance with the best interest of the customer, while promoting compatibility with the approach under MiFID II.

This option would read as follows:

"An inducement or inducement scheme has a detrimental impact on the quality of the relevant service to the customer if it is of such a nature and scale that it provides an incentive to carry out the insurance distribution activities in a way which is not in accordance with the best interest of the customer".

Policy Issue 2 - Inducements at risk of causing a detrimental impact: high risk inducements

The Commission has requested EIOPA to indicate examples of circumstances where an inducement may generally be regarded as having a detrimental effect on the quality of the relevant service to the customer.

EIOPA has considered the following options to address this issue:

- **Option 2.1-** Do nothing

It means not to identify inducements that are considered to constitute a high risk of having a detrimental impact.

- **Option 2.2-** Definition of inducements not enhancing quality of service

This option apply the rationale which underlies the Commission's Delegated Directive under MiFID II and defines the circumstances where inducements (do not) enhance the quality of the relevant service.

The relevant part can be found in Article 11(2) of the proposed delegated Directive stating:⁴⁸

A fee, commission or non-monetary benefit shall be considered to be designed to enhance the quality of the relevant service to the client if all of the following conditions are met:

(a) it is justified by the provision of an additional or higher level service to the relevant client, proportional to the level of inducements received, such as:

(i) the provision of non-independent investment advice on and access to a wide range of suitable financial instruments including an appropriate number of instruments from third party product providers having no close links with the investment firm;

(ii) the provision of non-independent investment advice combined with either: an offer to the client, at least on an annual basis, to assess the continuing

⁴⁸ http://ec.europa.eu/finance/securities/docs/isd/mifid/160407-delegated-directive_en.pdf

suitability of the financial instruments in which the client has invested; or with another on-going service that is likely to be of value to the client such as advice about the suggested optimal asset allocation of the client; or

(iii) the provision of access, at a competitive price, to a wide range of financial instruments that are likely to meet the needs of the client, including an appropriate number of instruments from third party product providers having no close links with the investment firm, together with either the provision of added-value tools, such as objective information tools helping the relevant client to take investment decisions or enabling the relevant client to monitor, model and adjust the range of financial instruments in which they have invested, or providing periodic reports of the performance and costs and charges associated with the financial instruments

(b) it does not directly benefit the recipient firm, its shareholders or employees without tangible benefit to the relevant client;

(c) it is justified by the provision of an on-going benefit to the relevant client in relation to an on-going inducement.

A fee, commission, or non-monetary benefit shall not be considered acceptable if the provision of relevant services to the client is biased or distorted as a result of the fee, commission or non-monetary benefit.

- **Option 2.3** - List of inducements with risks

This option consists in developing a distinctive list of criteria which insurance undertakings and insurance intermediaries should consider when assessing the detrimental impact on the quality of the relevant service to the customer.

This option would read as follows:

Insurance undertakings and insurance intermediaries shall assess all relevant factors which increase or decrease the risk of detrimental impact on the quality of the relevant service to the customer.

Insurance undertakings and insurance intermediaries shall take consideration into the following criteria in order to assess whether inducements or inducement schemes increase the risk of detrimental impact:

a) the inducement or inducement scheme encourages the insurance intermediary or insurance undertaking carrying out distribution activities to offer or recommend a product or service to a customer when the insurance intermediary or insurance undertaking could, from the outset, propose a different available product or service which would better meet the customer's needs;

b) the inducement or inducement scheme is solely or predominantly based on quantitative commercial criteria and does not take into account appropriate qualitative criteria, reflecting compliance with the applicable regulations, fair treatment of customers and the quality of services provided to customers;

c) the value of the inducement is disproportionate when considered against the value of the product and the services provided in relation to the product;

- d) *the inducement is entirely or mainly paid upfront when the product is sold without any appropriate refunding mechanism if the product lapses or is surrendered at an early stage;*
- e) *the inducement scheme does not provide for an appropriate refunding mechanism if the product lapses or is surrendered at an early stage;*
- f) *if the inducement scheme entails any form of variable or contingent threshold or any other kind of value accelerator which is unlocked by attaining a sales target based on volume or value of sales.*

Policy Issue 3 – Circumstances that may reduce the risk of detrimental impact

The Commission's request for advice allows discretion for EIOPA to complement the Technical Advice: "*This could be complemented by an exemplary enumeration of circumstances where third-party payments and benefits are generally considered acceptable*".

EIOPA has considered the following options to address this issue:

- **Option 3.1.** – Exemplary enumeration of circumstances that may reduce the risk of detrimental impact
- **Option 3.2.** – Amend the organisational requirements on inducements, in particular introduce organisational measures for the assessment of detrimental impact
- **Option 3.3.** – Do nothing

Policy Issue 4 - Organisational requirements related to inducements

Policy options

- **Option 4.1** - Not specific organisational requirements related to inducements
- **Option 4.2** – Requirements in MIFID II

That is to apply the same organisational requirements as outlined in the Commission's proposal for a Delegated Directive for MiFID II

The relevant part can be found in Article 11 (4) of the proposed Delegated Directive:⁴⁹

"Investment firms shall hold evidence that any fees, commissions or non-monetary benefits paid or received by the firm are designed to enhance the quality of the relevant service to the client:

- (a) by keeping an internal list of all fees, commissions and non-monetary benefits received by the investment firm from a third party in relation to the provision of investment or ancillary services; and*

⁴⁹ http://ec.europa.eu/finance/securities/docs/isd/mifid/160407-delegated-directive_en.pdf

(b) by recording how the fees, commissions and non-monetary benefits paid or received by the investment firm, or that it intends to use, enhance the quality of the services provided to the relevant clients and the steps taken in order not to impair the firm's duty to act honestly, fairly and professionally in accordance with the best interests of the client."

- **Option 4.3** – Specific requirements for insurance

This option consists in developing organisational requirements based on the specificities of insurance intermediaries and undertakings distributing insurance-based investment products. The policy proposal requires insurance undertakings and insurance intermediaries to take adequate organisational measures to assess the detrimental impact of inducements. The policy proposal clarifies that the assessment should be based upon an overall analysis which takes into consideration all risk-increasing and risk-reducing factors.

This would be read as follows:

"Insurance undertakings and insurance intermediaries should maintain and operate organisational arrangements procedures in order to assess on an ongoing basis and ensure that the generic inducement paid for a particular type of contract and the structure of inducement schemes which they pay to or receive:

- a. do not lead to a detrimental impact on the quality of the service provided to customers and*
- b. do not prevent the intermediary or insurance undertaking from complying with their obligation to act honestly, fairly and in accordance with the best interests of their customers.*

The assessment should be based upon an overall analysis which takes into consideration all relevant factors which may increase or decrease the risk of detrimental impact, and appropriate organisational measures taken by the insurance undertaking or insurance intermediary to decrease the risk of detrimental impact which aim to ensure that the inducements do not provide any incentive to carry out the insurance distribution activities in a way which is not in accordance with the best interest of the customer.

Insurance undertakings and insurance intermediaries as referred to in paragraph 1 should ensure that any inducement scheme is approved by the insurance undertaking or insurance intermediary's senior management.

Insurance intermediaries and insurance undertakings as referred to in paragraph 1 should document the assessment referred to in paragraph [x - above] in a durable medium.

As part of the conflicts of interest policy (as outlined under ...) insurance intermediaries and insurance undertakings should set up a gifts and benefits policy that stipulates what benefits are acceptable and what should happen where limits are breached".

C.4 – Analysis of impacts

Policy Issue 1 - Inducements at risk of causing a detrimental impact: high-level principle

Option 1.1 – do not introduce a high-level principle

Benefits:

- For customers: no specific benefits identified
- For industry: no specific benefits identified
- For NCAs: wide discretion on how to interpret and apply in practice the abstract term “detrimental impact” enabling to take into account specificities of national markets and existing business models

Costs:

- For customers: Different level of customer protection across the Member States as a result of the development of diverging understanding of detrimental impact
- For industry: No additional guidance on the understanding of detrimental impact would cause legal uncertainty for market participants leading to additional costs to comply with the new requirements; bespoke diverging understanding of detrimental impact will also have negative impact on cross-border distribution of insurance-based investment products as insurance undertakings and insurance intermediaries will be confronted with different national understanding of detrimental impact
- For NCAs: need to develop a national understanding of detrimental impact to provide guidance to participants of the respective national markets

Option 1.2 – introduce the criterion of quality enhancement

Benefits:

- For customers: Increased customer protection and quality of service as inducements would be beneficiary and serve the customer’s interests; equivalent level of customer protection, not only across Member States, but also from a cross-sectoral perspective.
- For industry: Legal certainty about the understanding of detrimental impact would reduce advisory/compliance costs for implementation; level playing field across Member States and different financial sectors; in the long run increased confidence and trust of customers in the services provided.
- For NCAs: No need to develop national understanding of detrimental impact; provides support and guidance for consistent application and implementation in national law.

Costs:

- For customers: Extensive understanding of detrimental impact may have negative consequences for existing business models leading to a reduced competition and choice of products/providers/services in the market

- For industry: Extensive understanding of detrimental impact may have negative consequences for existing business models (lower revenues), in particular those which are entirely financed by commissions; some entities might be required to change the structure of their income; training costs for employees.
- For NCAs: Costs for supervision and enforcement. Training costs for employees.

Option 1. 3 – introduce a high-level principle based upon Article 17 IDD

Benefits:

- For consumers: Increased customer protection as the risk of conflicts of interest arising from inducements is addressed; equivalent level of customer protection across the Member States providing a level playing field, whereas not identical, but compatible with policy requirements developed under MiFID II.
- For industry: Legal certainty about the understanding of detrimental impact would reduce advisory/compliance costs for implementation; level playing field across Member States; in the long run increased confidence and trust of customers in the services provided.
- For NCAs: No need to develop national understanding of detrimental impact; provides support and guidance for consistent application and implementation in national law.

Costs:

- For customers: Negative consequences on competition and choice of products/providers/services as outlined under Policy Option 2 less relevant, even though not to be excluded from the outset.
- For industry: Even though less relevant, impact on existing business models (lower revenues) cannot be excluded as some common inducements might be considered as having a detrimental impact; training costs for employees.
- For NCAs: Costs for supervision and enforcement. Training costs for employees.

Policy Issue 2 - Inducements at risk of causing a detrimental impact: high risk inducements

Option 2.1 – do not identify inducements that are considered to be high risk of having a detrimental impact

Benefits:

- For customers: no specific benefits identified
- For industry: no specific benefits identified
- For NCAs: wide discretion on how to interpret and apply in practice the high-level principle enabling them to take into account specificities of national markets and existing business models

Costs:

- For customers: less consistent application of the high-level principle will lead to a diverging level of customer protection across the Member States. This may lead to a situation where some Member States develop a very strict and rigid understanding of detrimental impact, whereas other Member States follow a more flexible and less severe approach.
- For industry: No guidance on the high-level principle. Differences in national regulation will hamper the cross-border distribution of insurance products and contravene the principle of a level playing field across Europe.
- For NCAs: No guidance on the high-level principle and the need to develop a proper understanding on national level.

Option 2.2 - apply the rationale which underlies the Commission's Delegated Directive under MiFID II

Benefits:

- For customers: As inducements are supposed to provide an additional or higher level of service to the customer, inducements directly benefit the customer.
- For industry: Increased confidence and trust of customers in the services provided which will be beneficiary for the industry in the long run.
- For NCAs: Detailed guidance on the legitimacy of inducements provides legal certainty and supports NCA's in their implementation and supervision.

Costs:

- For customers: Possible negative consequences for existing business models, in particular those which mainly rely on commissions to finance their business models as well as small intermediaries, leading to a reduced competition and choice of products/providers/services in the market
- For industry: Possible negative consequences for existing business models (lower revenues), in particular those which are entirely financed by commissions; some entities might be required to change the structure of their income; training costs for employees.
- For NCAs: Costs for supervision and enforcement. Training costs for employees.

Option 2.3 - develop a distinctive list of inducements which are considered to have a high risk of leading to a detrimental impact on the quality of the relevant service to the customer

Benefits:

- For customers: A distinctive list of inducements makes insurance intermediaries and insurance undertakings aware of inducements which entail a high risk of detrimental impact on the service provided and requires either, if possible, to take appropriate organisational measures to mitigate the risks, or, if not

possible, to abstain from paying or receiving these inducements. Therefore, the distinctive list strongly supports the legislative purpose to avoid any detrimental impact on the quality of service provided to the customer.

- For industry: Increased confidence and trust of customers in the services provided which will be beneficiary for the industry in the long run.
- For NCAs: A distinctive list of inducements will help NCAs to supervise and enforce the new requirements on inducements as laid down in Article 29 IDD.

Costs:

- For customers: Although less relevant as for policy option 2, possible negative consequences for existing business models, in particular those which mainly rely on commissions to finance their business models as well as small intermediaries, leading to a reduced competition and choice of products/providers/services in the market
- For industry: Although less relevant as for policy option 2, possible negative consequences for existing business models (lower revenues), in particular those which are entirely financed by commissions which are considered to have a high risk of detrimental impact; some entities might be required to change the structure of their income; training costs for employees.
- For NCAs: Costs for supervision and enforcement. Training costs for employees.

Policy Issue 3 – Circumstances that may reduce the risk of detrimental impact

Policy Option 3.1 - Exemplary enumeration of circumstances that may reduce the risk of detrimental impact

Benefits:

- For customers: No specific benefits identified
- For industry: More guidance on circumstances under which the risk of detrimental impact is reduced provides more legal clarity and certainty for market participants (a “safe harbour”).
- For NCAs: More guidance on circumstances under which the risk of detrimental impact is reduced may provide more legal clarity and certainty for NCAs for the purposes of supervision and enforcement (a “safe harbour”).

Costs:

- For customers: Enumeration of circumstances raises the risk of loopholes, enabling regulatory circumvention, leading ultimately to a lower level of customer protection
- For industry: No specific costs identified
- For NCAs: Exemplary enumeration of circumstances that may reduce the risk of detrimental impact, will raise the question how to weigh these circumstances against the exemplary list of high-risk practices and may restrict

the ability of NCAs to take prohibitive action regarding inducements both *ex ante* and *ex post*. In addition, it is very challenging for NCAs to future-proof such a list to allow for market and technological developments.

Policy Option 3.2 - Amend the organisational requirements on inducements, in particular introduce organisational measures for a holistic assessment of detrimental impact

Benefits:

- For customers: From a more general point of view, organisational measures aim to ensure that insurance undertakings and intermediaries comply with the regulatory requirements for the benefit of the customer
- For industry: Depending on the organisational measures taken insurance undertakings and insurance intermediaries are in a better position to manage the risk of detrimental impact stemming from specific types of inducements
- For NCAs: Specific organisational measures will help NCAs to monitor and supervise insurance undertakings and insurance intermediaries

Costs:

- For customers: No specific costs identified and the costs of introducing organisational measures should not be passed by insurance undertakings and insurance intermediaries onto customers
- For industry: Costs for the implementation of the organisational requirements, for example, new systems and controls and training of compliance and sales staff
- For NCAs: Potentially, additional costs related to the supervision of insurance undertakings and insurance intermediaries if existing national rules do not address such organisational measures

Policy Option 3.3 – Do nothing

Benefits:

- For customers: No risk of watering down the list of high-risk practices or the creation of loopholes for circumvention, thus maintaining a higher level of customer protection.
- For industry: No specific benefits identified
- For NCAs: No additional costs for supervision and no need to future-proof a list of risk-reducing factors to take account of market and technological developments.

Costs:

- For customers: No specific costs identified
- For industry: no guidance on circumstances under which the risk of detrimental impact is reduced

- For NCA: no guidance on circumstances under which the risk of detrimental impact is reduced

Policy Issue 4 - Organisational requirements related to inducements

Policy Option 4.1 – not specify organisational requirements related to inducements

Benefits:

- For customers: No specific benefits identified
- For industry: No additional costs resulting from the establishment and maintenance of organisational arrangements; more discretion regarding the choice of organisational measures.
- For NCAs: No specific benefits identified

Costs:

- For customers: As organisational measures aim to ensure that entities comply with regulatory requirements, a lack of specification may prove disadvantageous from a customer point of view
- For industry: No guidance on organisational requirements related to inducements may cause additional costs to set up corresponding measures
- For NCAs: No guidance on organisational requirements related to inducements

Policy Option 4.2 and 4.3 – to specify organisational requirements related to inducements

As Policy Option 2 and Policy Option 3 have many similarities and share the same legislative purpose to ensure that entities comply with the regulatory requirements on inducements which have been introduced through the respective sectoral legislation, the costs and benefits analysis below covers both options at the same time.

Benefits:

- For customers: From a more general point of view, organisational measures aim to ensure that insurance undertakings and intermediaries comply with the regulatory requirements for the benefit of the customer
- For industry: Having good systems and controls in place supports firms' compliance with inducement requirements
- For NCAs: Record keeping requirements enable better supervision and assessment of where firms are not complying with requirements

Costs:

- For customers: Potential costs passed through from increased compliance costs
- For industry: Costs for setting up new systems and controls, whereas the specific costs depend on the organisational requirements required
- For NCAs: Additional material to assess

C.5 – Comparison of options

Policy Issue 1 - Inducements at risk of causing a detrimental impact: high-level principle

Not introducing a high-level principle (as proposed by Option 1.1) would lead to legal uncertainty for market participants and the development of different level of customer protection across the Member States as a result of a divergent understanding of detrimental impact by market participants and NCAs in the Member States. This would result in obstacles for cross-border business and, therefore, hamper the further development of a single market in Europe.

Against this background, EIOPA considers it necessary to provide further guidance in Level 2 under which circumstance inducements entail the risk of having a detrimental impact on the service provided to customers.

With regard to Policy Option 1.2 (introduce the criterion of quality enhancement), EIOPA would like to note that it would ensure a maximum alignment with the regulatory requirement under MiFID II leading to a cross-sectoral level playing field. However, EIOPA acknowledges that the corresponding Level 1 provisions in IDD differ fundamentally in terminology and language and set a different standard, even though they pursue the same legislative goal to foster the protection of customers.

For that purpose, EIOPA considers it appropriate and essential to develop a methodology which is compatible with MiFID, but takes into account the specificities of the insurance sector and differences in terminology used in the corresponding Level 1 provisions. For that reason, EIOPA favours **Option 1.3 (introduce a high-level principle based upon Article 17 IDD)** which provides an adequate level of legal certainty about the understanding of detrimental impact which is based upon the general principle in Article 17(3), IDD requiring insurance undertakings and intermediaries to act in accordance with the best interests of their customers.

This approach will help to develop a common understanding of detrimental impact across the Member States (further refined by list of inducements which are considered to have a high risk of detrimental impact, see below) and to foster the goal of a single market. At the same time, the impact of Option 1.3 on existing business models is presumably less significant than under Option 1.2 taking into consideration that Policy Option 1.3 adheres to the principle that business models can be financed by commissions, only.

Policy Issue 2 – Inducements at risk of causing a detrimental impact: high risk inducements

Whereas option 2.1 (do nothing) leaves a broad discretion to market participants and competent authorities on how to apply the high-level principle (as outlined under Policy Issue 1) and to consider specificities of national markets and existing business models, it implies that market participants and competent authorities develop their own understanding and interpretation, leading to a diverging level of customer protection across Member States and between market participants. Differences in national regulation, which are likely to arise as a result, will hamper cross-border

business and contravene the establishment of a single Market in Europe, to the disadvantage of all market participants and customers.

Taking into consideration that option 2.2 (definition of inducements not enhancing quality of service) would require that inducements are used to provide an additional or higher level of service to the customer, existing distribution models which are mainly financed by commission (and are still relevant in some Member States) would be hit hard and be required to find other sources of revenues and to give up their existing business models. Moreover, option 2.2 would not acknowledge the differences between the respective provisions in IDD and MiFID. In view of these implications which have to be assessed against the principle decision that commissions continue to be a valid form of financing distribution, EIOPA has a preference for Policy Option 3 and to single out specific inducements which increase the risk of having a detrimental impact on the services provided to the customer.

EIOPA believes that **option 2.3 (list of inducements with risks)** provides the appropriate balance between the intermediaries' interests to receive commissions to (partly) finance their business and the customer's interest to benefit from unbiased services. Policy Option 2.3 is supposed to preclude inducements only which are of the most regulatory concern from a customer protection perspective as they bear a significantly higher level of risk that the insurance undertaking or insurance intermediary will not act in the best interest of its customers when receiving these kinds of inducements, except if the insurance undertaking or insurance intermediary is able to take appropriate organisational measures to mitigate these risks appropriately (a holistic assessment).

Policy Issue 3 - Circumstances that may reduce the risk of detrimental impact

EIOPA would like to emphasise that an exemplary enumeration of circumstances that could be considered as reducing the risk of detrimental impact (Option 3.1) entails the high risk of creating loopholes for regulatory arbitrage and may restrict the ability of NCAs to take prohibitive action in relation to inducements both *ex ante* and *ex post*⁵⁰.

In addition, there is the risk that such a list can become outdated and does not reflect current market and technological developments. It could be very challenging for an NCA to "future-proof" a white list or construct it in such a way so as to ensure that insurance undertakings or insurance intermediaries do not misinterpret it more widely than is intended and in such a way as to circumvent the inducement rules. This is supported by factual evidence provided by a national competent authority which experienced that similar safe harbour provisions in their respective national law foiled the achievement of the legislative purpose of strengthening the protection of customers.⁵¹

⁵⁰ See Article 29(3), IDD

⁵¹ In the FCA's Inducement rules, it was recognised that some payments or benefits offered by providers to advisory firms can be in customers' best interest, and the conflicts of interest arising can be managed. Two thematic projects by the UK FCA following the introduction of the Retail Distribution Review (RDR) showed how some firms took an overly broad interpretation of this to justify a wide range of benefits that in the FCA's view, did not meet the inducements rules. In the end, the FCA was obliged to issue further guidance to dispel any ambiguity around the interpretation of the white list:

Therefore, EIOPA recommends not including such a list in the technical advice. However, EIOPA acknowledges that specific circumstances may be considered reducing the risk of detrimental impact on the quality of the relevant service to the customer and could be taken into consideration as part of an overall-assessment.

Therefore, EIOPA proposes to amend the organisational requirements on inducements for that purpose, in particular to introduce organisational measures for the holistic assessment of detrimental impact where high-risk factors may be counterbalanced with appropriate organisational measures which aim to ensure that the insurance distribution activities are carried out in compliance with the insurance intermediary's or insurance undertaking's duty to act honestly, fairly and professionally in accordance with the best interests of its customers. In view of the positive effects of Option 3.2, from a consumer protection point of view and from the view of the industry, EIOPA considers it preferable to choose Option 3.3.

Policy Issue 4 - Organisational requirements

EIOPA considers it important to specify the organisational requirements related to inducements as organisational arrangements help to ensure that insurance undertakings and insurance intermediaries comply with the regulatory requirements for the benefit of the customer. Having appropriate organisational arrangements does not only support compliance with the regulatory requirements, but also enables better supervision and assessment by the NCAs.

In view of the underlying requirement to assess whether inducements have a detrimental impact on the quality of service, EIOPA considers **option 4.3 (specific requirements for insurance)** as the most appropriate as it is closely linked to the obligation to undertake an assessment requiring that the assessment is approved by the senior management and is duly documented. In view of its practical relevance for employees, EIOPA considers it also appropriate to require insurance intermediaries and insurance undertakings to set up a gifts and benefits policy which should be made available to all staff members.

D. Assessment of suitability and appropriateness and reporting

a) Information to obtain when assessing the suitability or appropriateness of insurance-based investment products for their customers

1- Problem definition

The recent financial crisis and debates on the quality of advice clearly underline that access to more complex products needs to be strictly conditional on a proven understanding of the risks involved.

More clarity is thus needed as to the kind of service provided by the distributor and to the conditions attached to the provision of advice. Compounded by cases of mis-selling amid the financial crisis and specific national cases more recently, the number of complaints regarding the quality of advice has also been increasing. In view of the complexity of financial markets and products, customers often depend to a large extent on suitable recommendations provided by distributors.

Information should, therefore, be collected from customers in order to define those services or products which are suitable for them. For this purpose two different levels of information are developed:

- a) Level of information related specifically to the appropriateness of product for the customer;
- b) Level of information related specifically to the suitability of the product for the customer (more detailed).

Suitability and appropriateness requirements generally aim at ensuring that distributors only make suitable personal recommendations and that distributors assess whether customers have the necessary expertise, knowledge and financial capacity to do business in financial products and to understand associated risks given their investment objectives.

The IDD seeks to ensure a higher level of consumer protection, which includes more specific standards for the distribution of insurance-based products. *Inter alia*, the IDD sets out a framework of professional and organisational requirements⁵² for insurance distributors and the additional requirements with regard to the information to obtain for the assessment of suitability and appropriateness of insurance-based investment products, complement those requirements and are necessary in order to ensure that insurance distributors act "*honestly, fairly and professionally in accordance with the best interests of their customers*"⁵³. When distributing insurance-based investment products, the insurance intermediary or insurance undertaking should gather the necessary information to ensure that they can assess in a proportionate way the appropriateness or suitability of such products.

The following provisions of the IDD are relevant in this context:

⁵² Article 10, IDD

⁵³ Article 17(1), IDD

- Article 30(1), IDD provides for a so-called “**suitability assessment**” whereby, where the insurance intermediary or insurance undertaking provides advice to the customer on the distribution of an insurance-based investment product, the intermediary or the insurance undertaking has to “also” obtain the necessary information regarding the customer’s knowledge and experience in the investment field, financial situation and investment objectives in order to recommend to the customer the insurance-based investment products that are suitable for that person.
- Article 30(2), IDD provides for a so-called “**appropriateness assessment**” whereby, where the insurance intermediary or insurance undertaking carries out insurance distribution activities regarding insurance-based investment products in relation to sales where no advice is given, the intermediary or insurance undertaking only needs to ask the customer for information on their knowledge and experience in the investment field in order to assess whether the product is appropriate for the customer. The amount of information required is, therefore, lower than the suitability assessment and a risk warning needs to be provided to the customer in case the product is considered inappropriate for the individual customer.

In both cases, both provisions are without prejudice to the requirements under Article 20(1), IDD, to ensure that prior to the conclusion of an insurance contract, the contract proposed is consistent with the customer’s insurance demands and needs (**the “demands and needs test”**).

Under Article 30(6), IDD, the Commission is **empowered to adopt delegated acts** in accordance to further specify how insurance intermediaries and insurance undertakings are to comply with the principles set out in Article 30, IDD, when carrying out insurance distribution activities with their customers, including with regard to the information to be obtained when assessing the suitability and appropriateness of insurance-based investment products for their customers, the criteria to assess non-complex insurance-based investment products for the purposes of execution-only business, and the content and format of records and agreements for the provision of services to customers and of periodic reports to customers on the services provided. The IDD delegated acts should take into account:

- the nature of the services offered or provided to the customer or potential customer, taking into account the type, object, size and frequency of the transactions;
- the nature of the products being offered or considered including different types of insurance-based investment products;
- the retail or professional nature of the customer or potential customer.

2- Objectives

Taking account the Commission's mandate, the objectives of the technical advice are to:

Objective 1: Promote a consistent level of customer protection and avoid the risk of regulatory arbitrage, but also take into account the specificities of the insurance sector

Objective 2: Clarify the different levels of information that should be acquired to meet the obligations of the suitability and appropriateness assessments

Objective 3: Ensure the information gathered is necessary and proportionate to the objectives pursued

Objective 4: Take into account information needs with respect to the retail or professional nature of the customer or potential customer

These objectives are consistent with the general objectives of the IDD.

3- Policy options

With the intention to meet the objectives set out in the previous section, EIOPA has analysed different policy options throughout the policy development process.

- **Option 1** - Fully consistency with MIFID II

This Option consists in ensuring *full* consistency with the provisions in the draft Commission Delegated Act under Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments ("MiFID II"), pertaining to the information to be obtained from the customer under the suitability and appropriateness assessments, by applying the wording and the concepts of MiFID, without any adaptations of substance or terminology to take into account the specificities of the insurance sector. This option takes into consideration the very close alignment between the provisions on suitability and appropriateness at Level 1 under MiFID II and IDD and would ensure full regulatory consistency with the draft MiFID II Delegated Regulation, as requested by the Commission.

For this Policy Option, to the extent appropriate for the product or service, the types of information to be collected from the customer regarding their *financial situation* under the suitability assessment (distribution of insurance-based investment products with advice) include the following:

- *Financial situation of the customer:*
 - Regular income;
 - Assets (including liquid assets);
 - Investments and real property; and
 - Regular financial commitments
- *Investment objectives of the customer:*
 - The length of time, which the customer wishes to hold the investment;
 - The customer's preferences regarding risk-taking

- The customer's risk profile
- The purposes of the investment

For this Policy Option, to the extent appropriate for the product or service, the types of information to be collected from the customer regarding their *investment objectives* under both the suitability and appropriateness assessments (distribution of insurance-based investment products both with and without advice) regarding their knowledge and experience in the investment field, include the following:

- The types of service, transaction and financial instrument with which the customer is familiar;
- The nature, volume and frequency of the customer's transactions in financial instruments and the period over which they have been carried out; and
- The level of education, and profession or relevant former profession of the customer.

- **Option 2** - MIFID II + adaptation to insurance

This Option consists in ensuring consistency with the provisions in the draft MiFID II Delegated Regulation pertaining to the information to be obtained from the customer under the suitability and appropriateness assessments, but adapting some key elements of the substance and terminology used in those provisions further to reflect insurance specificities.

In addition, notwithstanding the requirement to obtain certain information from the customer under the suitability and appropriateness assessments and the existence of several references already in Article 30, IDD to the "demands and needs" test, a specific legal reference would be included to make clear that the "demands and needs" test under Article 20(1), IDD is mandatory and always has to be fulfilled by the insurance intermediary or insurance undertaking

As with Policy Option 1 above, the information to be obtained would be very similar; however, with some key differences to take into account the specificities of the insurance sector:

- The necessary information to be collected from the customer as regards the customer's knowledge and experience in the investment field under both the suitability and appropriateness assessments, **would capture the nature, volume and frequency of the customer's transactions in both insurance-based investment products and MiFID financial instruments**, providing a more complete picture for the insurance intermediary or insurance undertaking;
- Concepts more closely related to the activity of **"portfolio management"** under MiFID II (for example, **recommendations of specific "transactions"** in insurance-based investment products) would be deleted or adapted in order to take **due consideration of their relevance for the insurance sector**;

- The customer's experience and knowledge to understand the **"investment risks"** in certain types of transactions and **his/her ability to bear those "investment risks"**, would be adapted to refer to the customer's knowledge and experience in the "investment field" and their ability to bear "losses".
- The notion of **"group insurance contracts"**, namely collective contracts where more than one person is insured or participating as a contractual party, would be adequately reflected in the Technical Advice.
- **The "professional customer" regime in Annex II to MiFID II, would not be applied one-to-one to the insurance sector, without consideration of the lack of an existing customer classification regime under the IDD** (notwithstanding an exemption for large risks in certain cases regarding the distribution of non-insurance-based investment products).

In addition, as regards Article 54(9) of the draft MiFID II Delegated Regulation, EIOPA would seek to avoid any confusion or legal uncertainty with provisions on Product Oversight and Governance (POG) in the envisaged Delegated Act under IDD on POG, by not copying across Article 54(9).

- **Option 3** - Specific approach for IBIPs

This Option consists in taking a materially different approach to MiFID II with regard to the assessment of suitability by including, in EIOPA's Technical Advice, a requirement for substantively different types of information to be obtained from the customer in order to fully take into account the customer's "basic needs" and certain "insurance-specific elements" of an insurance-based investment product. The option would put a stronger focus also on the protection elements within the insurance-based investment product (e.g. biometric risk cover). The approach is also linked to argumentation that insurance-based investment products can be particularly complicated products for consumers to understand, as compared to potentially substitutable financial instruments under MiFID II. In addition, not all the provisions envisaged under Articles 54 -56 of the draft MiFID II Delegated Regulation would be copied across.

Depending on the national interpretation of the "the demands and needs test" in Article 20(1), IDD, this might reflect information requirements already required under the "demands and needs" test. However, the scope of the "demands and needs" test is not explicitly referred to in the Technical Advice under this option⁵⁴. In addition, not all the provisions envisaged under Articles 54 -56 of the draft MiFID II Delegated Regulation would be copied across.

This approach has as a starting point **that a homogeneous in-depth analysis** should be carried out by insurance intermediaries or insurance undertakings to safeguard the suitability of the insurance product for the customer.

⁵⁴ As stated on page 5, the Commission's empowerment for delegated acts under Article 30(6), IDD, does not explicitly refer to the information to be obtained under the "demands and needs" test.

This approach would consist in taking the information to be obtained from the customer under the suitability assessment under MiFID II (as set out in Policy Option 1) as a starting point and substantively adapting this not only to the language and concepts of the insurance sector, but most importantly, including other types of information to be collected from the customer in order to ensure that insurance-based investment products meet not only the investment needs of the customer, but also, and in some cases, what is perceived to be the basic insurance-specific needs of the customer.

EIOPA's online survey on the IDD in early 2016⁵⁵ indicated that some stakeholders suggested to include information, under the suitability assessment, such as age, marital status, insurance coverage, risk tolerance, insurance period, health, existing obligations, dependant family (or other) persons, tax and social security, the customer's income and wealth, information on the source of their regular income, and their reason to seek advice from the distributor. The aforementioned criteria of information to collect from customers would differ from the information to collect under the MiFID framework for the assessment of suitability.

Option 3 would capture the following additional information elements to be included in the suitability assessment (a type of "*suitability assessment plus*") to capture all possible relevant aspects for understanding the "insurance-specific needs" of the customer (to the extent that those would not already be captured under the requirements laid down in the MiFID II delegated act⁵⁶) and make a decision whether to buy an insurance-based investment product or not:

- Personal data (customer's age, personal characteristics, the place of residence);
- The reasons for purchasing a life insurance product (retirement, protection of family in case of death, investment);
- Information about persons to be covered/protected under the policy;
- The customer's employment and level of education;
- Information regarding the customer's tax and social security situation.
- The customer's income and wealth;
- The customer's existing investment and insurance portfolio;
- The customer's existing financial obligations (loans, debts etc.);
- the customer's liquidity expectations;
- The reason for seeking advice from the insurance intermediary or the insurance undertaking, in particular expectations from the contract in terms of coverage, duration and any financial risks related to the contract to be concluded.

⁵⁵ Online survey in preparation for the Call for Advice from the European Commission on the delegated acts under the Insurance Distribution Directive: <https://eiopa.europa.eu/Pages/Consumer-Protection/Online-survey-Call-for-Advice-from-EC-IDD.aspx>

⁵⁶ It is also worth noting that some of these elements have been addressed by ESMA regarding MiFID in their Guidelines on certain aspects of the MiFID suitability requirements 21 August 2012 | ESMA/2012/387, see para. 22 on page 6: https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-387_en.pdf

4- Analysis of impacts

Option 1 - Fully consistency with MiFID II

Impact on insurance intermediaries and insurance undertakings' economic position

The impact will differ depending, in particular, on whether the insurance intermediary or insurance undertaking in question are already subject to MiFID II provisions (for example, if they are already licensed to carry out regulated activities under MiFID II). In this case, additional costs would be avoided and insurance intermediaries or insurance undertakings would not need to adopt new procedures. In the case of insurance intermediaries or insurance undertakings, which are not yet subject to MiFID II provisions, insurance intermediaries would benefit from the knowledge and procedures already available for the distribution of financial instruments to retail clients under MiFID II provisions.

However, the application of MiFID II concepts to the insurance sector could have potential cost implications if these MiFID concepts do not fit with the distribution of insurance-based investment products. This is namely the case, where concepts/terminology contained in MiFID II (e.g. execution of orders, portfolio management) do not exist in the insurance sector and where the MiFID framework allows for assumptions with regard to the assessment of suitability and appropriateness of professional clients, as there is no specific client classification in IDD (other than an exemption for "large risks").

Impact on customer protection

This policy option would ensure a high level of *consumer protection*, notwithstanding that the assessment of suitability and appropriateness according to Article 30, IDD would need to be complemented by the "demands and needs" test of Article 20(1), IDD. In the latter case, the distributor has to specify the demands and the needs of a customer and has to provide the customer with objective information about the insurance product in a comprehensible form to allow that customer to make an informed decision.

Impact on competition and market structures:

From a competition perspective, this option promotes a consistent level of protection of customers and a level playing field across financial sectors, in line with Recital 56, IDD and the fact that the provisions of Article 30, IDD are virtually identical to equivalent provisions in MiFID II.

Option 2 - MiFID II + adaptation to insurance

This Option consists in reflecting insurance specificities with regard to the information to be acquired, by the intermediary and insurance undertakings, under the suitability and appropriateness assessments, while ensuring consistency with the assessment of suitability and appropriateness under the draft MiFID II Delegated Regulation. In addition, notwithstanding the requirement to obtain certain information from the customer under the suitability and appropriateness assessments, a specific legal reference to the fact that the "demands and needs" test under Article 20(1), IDD, always has to be carried out, has been added.

Under this policy option, EIOPA would:

- (i) Set the level of detail of information to be collected from the customer at an appropriate level and deliver consistent investor protection and avoid the risk of regulatory arbitrage by ensuring regulatory consistency with the draft MiFID II Delegated Regulation, as requested by the European Commission;
- (ii) Notwithstanding the existing reference at Level 1 to the “demands and needs” test, explicitly recognise at Level 2 that the “demands and needs” test is mandatory and always needs to be fulfilled, even in the case of the suitability and appropriateness assessments. The “demands and needs” is left to further national interpretation during the IDD implementation; and
- (iii) Take account of the fact that concepts/terminology contained in MiFID II (e.g. execution of orders, portfolio management) do not exist in the insurance sector and other concepts (e.g. collective insurance contracts) would need to be introduced.

Through this option, EIOPA delivers regulatory consistency to the extent possible with the equivalent provisions in the draft MiFID II Delegated Regulation (taking into account, the particular specificities of insurance products/distribution channels compared to MiFID financial instruments/firms) and thereby promotes a consistent level of consumer protection across financial sectors and a level playing field for firms.

Analysis according to the estimated impact on stakeholders

The following stakeholders and impacts have been assessed and are elaborated in slightly more detail than the other two policy options due to the fact that it is EIOPA’s preferred policy option:

- Impact on customer protection.

Pros

In this respect, this policy option has the following *positive* impacts in terms of customer satisfaction:

In case of the *appropriateness assessment*:

- Customer selection is made directly on the products required and there are lower costs and a prompter service for the customer, which takes into account their risk appetite, is provided. Customers are also not required to bear additional costs arising from the provision of advice, unlike with the suitability assessment.
- Potential additional costs passed on to the customer through the need for the insurance intermediary and insurance undertaking to request additional information over and above what is required when purchasing a suitable substitutable product, can be avoided.
- The explicit inclusion of insurance-specific concepts provides more legal certainty under the delegated acts.

In case of the *suitability assessment*:

- Customers are helped to achieve the level of awareness of their knowledge on key issues related to insurance-based investment products. Support is provided to understand the characteristics, benefits and limitations of the insurance product. This focuses information on the investment element of the life insurance product, given that such products can incorporate a structure, which makes it difficult for customers to understand them and makes the consumer aware of the increased risk that can be connected to the investment element so that the product is more suited to their own needs.
- A number of additional questions to the customer relating to their personal situation (see Option 3 below), irrespective of his/her level of financial literacy, would be avoided, with the avoidance of additional costs for the customer to bear and a possible deterrent effect for purchasing insurance-based investment products.
- The explicit inclusion of insurance-specific concepts provides more legal certainty under the delegated acts.

Cons

On the other hand, also this policy option may have the following *negative* impacts:

- Questions to the customer which relate to their personal situation, depending on the relevance of these questions in relation to the level of sophistication of the customer and the extent to which they are not captured under "*knowledge and experience in the investment field*" in Article 30(2). EIOPA could mitigate this potential negative impact further by issuing guidance on aspects relating to the personal situation of the customer, which are not caught by "*knowledge and experience in the investment field*".
- *Impact on the economic position of insurance intermediaries and insurance undertakings:*

Pros

In this respect, this policy option has the following *positive* impacts:

- Depending on the approach taken at national level, the insurance intermediary or insurance undertaking would be not required to collect more information from the customer, irrespective of their level of financial literacy and would be required to collect more information when selling an insurance-based investment product, as opposed to a substitutable product such as a UCIT, leading to additional compliance costs. If the insurance intermediary or insurance undertaking is licensed under both the IDD and MiFID II, they would

not be required to comply with two different sets of rules, leading to additional compliance costs and regulatory arbitrage.

- Customer loyalty towards the company, even in the case of the appropriateness assessment as a sophisticated investor can appreciate the benefits in terms of cost and efficiency of a non-advised sale as less information has to be collected from the customer;
- Both assessments (appropriateness and suitability) protect insurance intermediaries or undertakings with reference to the customer's choices.

Cons

In the other direction, this policy option may have the following *negative* impacts:

- An extensive list of information to mechanically gather customer data should not have the unintended consequence of leading to a mere “tick-box” exercise by insurance intermediaries and insurance undertakings in collecting information from the customer whilst not increase the quality of the actual advice provided.
- Where only the appropriateness assessment is performed, the insurance undertaking or insurance intermediary manages limited information. It is possible that in some Member States, where additional information is currently collected when an insurance-based investment product is sold based on the “demands and needs” test, less information to be collected on the basis of the suitability and appropriate assessments may result in increased costs related to implementing procedures to supervise the information obtained by the insurance intermediary or insurance undertaking and costs related to reviewing the documentation on the basis of the information they receive and provide information to the customer in order to ensure compliance with the new regulations.
- *Impact on competition and market structures:*
 - From this perspective, this option promotes a consistent level of protection of customers and a level playing field across financial sectors, in line with Recitals 10 and 56, IDD and the fact that the provisions of Article 30, IDD are virtually identical to equivalent provisions in MiFID II.
 - The option generates, within Europe, an aligned behaviour across financial sectors. The assessment of the investment component of the insurance product will be aligned to other sectors such as banking and securities, with the result that this will facilitate intermediaries/undertakings that sell both insurance-based investment products and MiFID financial instruments, thus substantially reducing compliance costs and assisting consumers in comparing between insurance-based investment products and substitutable products such as UCITS. For insurance products with an investment element, EIOPA seeks in its technical advice to adequately take into account the specificities of

insurance products (*namely, protection of customers against risks linked to human life*) and the distribution channels.

Option 3_- Specific approach for IBIPs

This Option consists in EIOPA developing relevant criteria to assess whether an insurance-based investment product is suitable for a customer, whereby EIOPA would take a materially different approach to MiFID II by including, in its Technical Advice, a requirement for substantively different types of information to be obtained from the customer in order to fully take into account the customer's "basic needs" and certain "insurance-specific elements" of an insurance-based investment product.

Impact on customer protection

This policy option could ensure a suitably high level of *customer protection* as with Option 2, but this approach would require substantively more information to be obtained from customers, irrespective of whether they are purchasing an insurance-based investment product or a substitutable product and irrespective of their level of financial literacy. That said, it could be assumed that more information under this type of "suitability assessment plus" could lead to a better assessment of the insurance contract and might be justified by the need for the insurance undertaking or insurance intermediary to provide additional advice, focussed specifically on the investment element of the insurance product.

However, customers would face different questions when shopping for retail investment products and could get the impression of different levels of consumer protection. In addition, the impact could be more pronounced in Member States where national regulation does not regulate the timing of obtaining information from, or delivering information to, the customer. In Member States where such legislation already exists on the timing of obtaining or delivering information, the customer might already be used to provide information related to their needs and conditions.

Impact on the economic position of insurance intermediaries and insurance undertakings

Distributors also subject to MiFID II requirements (i.e. licensed to carry out regulated activities under MiFID II) would need to ask their customers a number of additional questions to gather the necessary information to assess the suitability of substitutable investment products. This would result in potentially increased operational and compliance costs.

In addition, as mentioned in relation to Option 2 above, an extensive list of information to mechanically gather customer data should not have the unintended consequence of leading to a mere "tick-box" exercise by insurance intermediaries and insurance undertakings in collecting information from the customer whilst not increase the quality of the actual advice provided. This could potentially be seen as transferring legal risk/liability from the distributor to the customer, due to the fact that the distributor has to follow extensive rules, but not necessarily needs to reflect what is necessary and best for customers, whereas a more principles-based approach could avoid the unintended consequence of a "tick-box" approach.

Impact on competition and market structures:

From this perspective, this option creates additional entry barriers for the distribution of insurance-based investment products. Additional information to be collected from the customer could create the impression for the customer that insurance-based investment products are more complicated or would need more granular information to achieve the same level of consumer protection compared to other investment products. At the same time, customer loyalty could increase due to a more deep and complete analysis of personal needs. This could also reduce cancellation rates of insurance-based investment products which are not kept until maturity, thus ultimately increasing the economic benefit to policyholders. To date, no evidence suggests that all products with insurance-based investment elements would require more detailed and more burdensome distribution requirements, than potentially substitutable MiFID II financial instruments.

As referred to above, this approach has the potential to create a heightened risk of regulatory arbitrage, depending on whether an insurance intermediary or insurance undertaking is or is not licensed to carry out regulated activities under MiFID II, as well as IDD.

5- Comparison of options

Regarding the policy issue on the information to obtain under the suitability and appropriateness assessment, the Impact Assessment compares the three options developed on the basis of the analysis above.

The preferred policy option for this policy issue is **Option 2 (MIFID II + adaptation to insurance)**. Both Options 1 (fully consistency with MIFID II) and 2 are very similar in terms of the benefits and costs which they generate and in promoting a consistent level of consumer protection across financial sectors and preventing a risk of regulatory arbitrage. However, the advantage of Option 2 is that insurance specificities are reflected and thus reducing costs due to a lack of insurance specificity for insurance undertakings, insurance intermediaries and national competent authorities.

Option 3 (specific approach for IBIPs) would take into account more the "basic needs" of the customer (regardless of their level of financial literacy) and potentially some more insurance-specific elements. However, this approach could create substantial additional costs for the implementation of the assessment of suitability and appropriateness, while arguably not going beyond the level of consumer protection achieved under policy option 2. Furthermore, policy option 3 might involve a possible risk of regulatory arbitrage. Therefore, the additional costs of policy option 3 are not justified by tangible benefits for consumers.

b) **The content and format of records and agreements for the provision of services to customers**

1- **Problem definition**

Failure of insurance intermediaries and insurance undertakings to keep adequate records of their insurance distribution activities may prevent competent authorities from adequately fulfilling their supervisory objectives and taking necessary enforcement action. In that respect, insurance-based investment products represent a potentially increased risk to consumers.

Failure to keep adequate records of whether an insurance intermediary or insurance undertaking has complied with all relevant conduct of business obligations regarding the distribution of an insurance-based investment product, can be particularly damaging to customers for example, where a customer subsequently suffers financial detriment as a result of the product sold.

The Insurance Mediation Directive (IMD) did not include formal record-keeping obligations for insurance intermediaries regarding their insurance mediation activities, although some Member States may have introduced such obligations in their national frameworks, given the minimum harmonising nature of the IMD.

The IDD introduces a new framework for record-keep regarding the distribution of insurance-based investment products under Article 30(4), IDD, which is closely aligned with the approach taken under the MiFID I and MiFID II Directive to ensure a consistent level of protection for consumers and prevent regulatory arbitrage. Currently, insurance undertakings or insurance intermediaries with regulatory licences under both MiFID and IMD are only obliged to maintain records with regard to the sale of MiFID financial instruments, leading to regulatory arbitrage.

2- **Objective**

Objective 1: To ensure effective record-keeping requirements regarding the distribution of insurance-based investment products so as to:

- (i) Enable national competent authorities to fulfil their supervisory tasks and to impose sanctions under the IDD, where appropriate; and
- (ii) Ascertain whether insurance undertakings and insurance intermediaries have complied with all relevant conduct of obligations with respect to the distribution of insurance-based investment products.

Objective 2: In line with Recital 56, IDD⁵⁷, the technical advice should, to the extent possible, bearing in mind the minimum harmonising nature of the IDD and the particular specificities of insurance products/distribution channels compared to MiFID financial instruments/firms, ensure regulatory consistency with the delegated acts under MiFID II in the area of record-keeping.

⁵⁷ "Insurance-based investment products are often made available to customers as potential alternatives or substitutes to investment products subject to Directive 2014/65/EU. To deliver consistent investor protection and avoid the risk of regulatory arbitrage, it is important that insurance-based investment products are subject, in addition to the conduct of business standards defined for all insurance products, to specific standards aimed at addressing the investment element embedded in those products. Such specific standards should include provision of appropriate information, requirements for advice to be suitable and restrictions on remuneration".

Objective 3: Bearing in mind Objective 1, it seems appropriate to have a common understanding of the records which should be kept by the insurance intermediary or insurance undertakings pursuant to Article 30(4) of the IDD, taking into account the specificities of insurance products/distribution channels.

3- Policy options

With the intention to meet the objectives set out in the previous section, EIOPA has analysed different policy options throughout the policy development process.

The section below reflects the most relevant policy options that have been considered in relation to the respective **policy issue, namely information in terms of the documents which should be kept pursuant to Article 30(4), IDD.**

We have also listed relevant options which have been discarded in the policy development process.

- **Option 1-** Documentation of appropriateness assessment only

Under this option the record-keeping obligation should include only the documentation relating to the appropriateness assessment, in line with Article 56 of the draft MiFID II Delegated Regulation, thus promoting a consistent level of consumer protection across financial sectors and preventing regulatory arbitrage. However, specific record keeping rules for the assessment of suitability were not introduced in the MiFID II Delegated Regulation.

- **Option 2 –** Documentation of suitability and appropriateness

Under this option the recording-keeping should include not only the documentation relating to the appropriateness assessment, but also with regard to the suitability assessment, thereby going beyond the requirements of Article 56 of the draft MiFID II Delegated Regulation, but enhancing the level of customer protection due to creating the need for clear documentation of the suitability assessment.

4- Analysis of impacts

Option 1 – Documentation of appropriateness assessment only

This option lists the documentation relating to the appropriateness assessment only.

This option is in line with the MiFID II Delegated Regulation and the technical advice has been adapted in several places to take into account the specificities of the insurance sector. Member States could introduce this concept at their own discretion. This approach promotes a consistent level of consumer protection and prevents regulatory arbitrage across financial sectors. However, the specific record keeping rules for the assessment of suitability were introduced by ESMA Guidelines and would not be matched by rules in the insurance sector, as the scope of the ESMA Guidelines is limited and does not include insurance distributors.

Option 2 – Documentation of suitability and appropriateness

This option lists the documentation relating to both the suitability and appropriateness assessments.

This option goes beyond the draft MiFID II Delegated Regulation, but enhances the level of customer protection. This option can be viewed as specifying the general

obligation of record-keeping further for insurance undertakings and insurance intermediaries and, therefore, could lead to higher compliance costs. For firms that are subject to both the record-keeping rules set in ESMA Guidelines and the record-keeping rules set in future IDD delegated acts, the compliance costs would be not increased.

5- **Comparison of options.**

Regarding the policy issue on the record-keeping with regard to the suitability and appropriateness assessment, the Impact Assessment compares the two options developed on the basis of the analysis above.

The preferred policy option for this policy issue is **Option 2 (documentation of suitability and appropriateness)**. Policy option 2 sets clear expectations for the record keeping of the suitability assessment, which is of pivotal importance when providing personal recommendations to customers. The proper record-keeping of these events can be expected anyway from distributors under the IDD. Policy option 2 allows for the record-keeping in a more uniform way, also allowing national competent authorities to understand more easily if all underlying regulatory requirements were met.

c) **Content and format of periodic reports to customers on the services provided**

1- **Problem definition**

Insurance-based investment products represent a potentially increased risk to consumers. Failure of insurance intermediaries and insurance undertakings to report periodically to customers on the services they provide to those customers, for example, on costs information associated with transactions carried out in relation to insurance-based investment products, may potentially have adverse financial consequences for customers. This may be the case where those products do not continue to meet the customer's preference, objectives and other characteristics. Failure to provide periodic reports may, in the long run, inhibit the customer's ability to seek legal redress against those entities in the event of mis-selling.

The Insurance Mediation Directive (IMD) did not include formal periodic reporting obligations for insurance intermediaries regarding their insurance mediation activities, although some Member States may have introduced such obligations in their national frameworks, given the minimum harmonising nature of the IMD.

The IDD introduces a new framework for periodic reporting regarding the distribution of insurance-based investment products under Article 30(5), IDD, which is closely aligned with the approach taken under the MiFID I and MiFID II Directive to ensure a consistent level of protection for consumers and prevent regulatory arbitrage. Currently, insurance undertakings or insurance intermediaries with regulatory licences under both MiFID and IMD are only obliged to report periodically to customers with regard to the sale of MiFID financial instruments, leading to regulatory arbitrage.

2- **Objective**

Objective 1: Periodic reporting by insurance intermediaries and insurance undertakings is a key element to ensure transparency, simplicity, accessibility and fairness across the internal market for consumers. A proactive approach is needed to restore trust in the financial sector by ensuring that consumers are adequately protected from the risk of detriment. Consumers are becoming more aware of their rights and rightfully demand greater transparency, comparability and integrity on the part of firms.

Objective 2: To ensure effective periodic reporting by insurance intermediaries and insurance undertakings regarding the services provided in relation to the distribution of insurance-based investment products so as to:

- (i) Keep customers adequately informed on whether the insurance-based investment products they have purchased continue to meet their preferences, objectives and other characteristics; and
- (ii) Enable customers to seek appropriate legal redress in the event of mis-selling by those insurance intermediaries and insurance undertakings.

Objective 3: In line with Recital 56, IDD⁵⁸, the technical advice should, to the extent possible, bearing in mind the minimum harmonising nature of the IDD and the particular specificities of insurance products compared to MiFID financial instruments, ensure regulatory consistency with the delegated acts under MiFID II in the area of periodic reporting to customers on the services provided.

Objective 4: Bearing in mind Objective 1, it seems appropriate to have a common understanding of the content and format of periodic reports to customers on the services provided pursuant to Article 30(5) of the IDD, taking into account the particular specificities of insurance products compared to MiFID financial instruments.

3- Policy options

With the intention to meet the objectives set out in the previous section, EIOPA has analysed different policy options throughout the policy development process in relation to the content and format of periodic reports to customers on the services provided pursuant to Article 30(5) of the IDD.

- **Option 1:** Solvency II approach (Article 185)

The periodic communications to customers should only reiterate what was already introduced by Article 185 of Directive 2009/138/CE (Solvency II), thus promoting a consistent approach between IDD and Solvency II.

- **Option 2** - Solvency II approach +additional info where relevant

The periodic communications to customers should complement Article 185 of Directive 2009/138/CE (Solvency II), where relevant, with information such as values of each investment element embedded in the insurance-based investment product and costs associated with the transactions and services undertaken on behalf of the customer during the reporting period. A list of information relevant for insurance-based investment products should be introduced. This would extend the information to be communicated to the customer, but would enhance the level of consumer protection.

4- Analysis of impacts

Option 1- Solvency II approach (Article 185)

The impact would vary. As the Insurance Distribution Directive has introduced the concept of periodic communications to customers, limiting the information to existing information creates no additional burden for insurance undertakings. Furthermore, the ways of sharing this information with customers should be already established for insurance undertakings under Solvency II and reiterating this information periodically should not create additional compliance costs, as Article 185 of Directive 2009/138/CE (Solvency II) foresees already that the policyholder has to be kept informed throughout the term of the contract of certain changes. Costs for insurance

⁵⁸ "Insurance-based investment products are often made available to customers as potential alternatives or substitutes to investment products subject to Directive 2014/65/EU. To deliver consistent investor protection and avoid the risk of regulatory arbitrage, it is important that insurance-based investment products are subject, in addition to the conduct of business standards defined for all insurance products, to specific standards aimed at addressing the investment element embedded in those products. Such specific standards should include provision of appropriate information, requirements for advice to be suitable and restrictions on remuneration".

intermediaries would depend on the concrete way of gathering and communicating such information.

Option 2: Solvency II approach +additional info where relevant

The impact would vary depending on the relevance of individual information elements which would need to be communicated periodically to customers. The list of information would need to be created, which requires monitoring and compiling of such information.

5- **Comparison of options**

Regarding the policy issue on periodic communications to customers, the Impact Assessment compares the two options developed on the basis of the analysis above.

Option 2 (Solvency II approach +additional info where relevant) is the preferred option. The list of criteria allows for taking into account the type and the complexity of insurance-based investment products involved. Furthermore, option 2 makes the costs associated with the transactions and services undertaken on behalf of the customer transparent, which is required to enhance consumer protection and attain the above mentioned objectives.

E. The criteria to assess non-complex insurance-based investment products for the purposes of point (ii) of point (a) of paragraph 3 of Article 30

E.1 - Problem definition

Contracts for insurance-based investment products can be complicated and difficult to understand for consumers. Distributors, either insurance undertakings or insurance intermediaries, therefore play an important role in processing information for the consumer and guiding consumers in choosing suitable insurance policies.

Prior to the advent of the IDD, consumer protection standards for the sales of insurance-based investment products were not considered sufficient at EU level to reduce the risk of mis-selling of those products, as the IMD did not contain specific rules for the sale of life insurance products with an investment element. This was despite the fact that these products are generally more complicated and represent higher risks for retail consumers than other insurance products.⁵⁹ In view of this situation, IDD stipulates additional conduct of business rules for the sale of insurance-based investment products.

At the same time, it is important to bear in mind that certain types of customers may be interested in receiving execution-only services and may not be willing to pay for additional services they do not consider necessary. This may be the case, for instance, for customers who have a sufficient knowledge of financial markets (a high level of financial literacy) and are able to make their own investment choices.

In the interests of striking an appropriate balance between the competing considerations described in the paragraphs above, IDD provides a differentiation between complex and non-complex insurance-based investment products. Where an insurance-based investment product is considered to be non-complex, Member States may allow insurance distributors to not undertake some of the assessments (suitability and appropriateness) during the sales process that are normally necessary for the distribution of insurance-based investment products. Since, in these cases, the consumer does not benefit from the corresponding protection provided by these assessments, it is critical that only those products that are genuinely non-complex are sold in this way. The technical advice is concerned with the criteria to identify when certain types of insurance-based investment products are non-complex.

During the policy development process, the potential substitutability of financial instruments within the scope of the MiFID II Directive and insurance-based investment products governed by IDD needed to be borne in mind, as indicated by the Commission's Impact assessment on Packaged Retail Investment Products⁶⁰ and the

⁵⁹ These products are sold under the general rules that apply to the sale of all insurance products.

⁶⁰ <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52009SC0556> – Annex 1 – “what are packaged retail investment products?": “We do not consider all of the products under consideration to be perfect substitutes. Moreover, while they do compete for retail savings, it is not always accurate to treat them as being in direct competition. For example, unit-linked life policies often serve simply as a ‘wrapper’ for an investment in an underlying fund. In this case

Commission's call for evidence regarding "substitute" retail investment products, dated 26.10.2007⁶¹.

Baseline scenario

Without binding technical rules regarding the identification of non-complex insurance-based investment products, there is likely to be different approaches implemented by different Member States. In particular, this creates the risk of an inadequate level of consumer protection and in turn risks resulting in cases of mis-selling of insurance products where consumers are sold products on an execution-only basis, the risks of which they do not properly understand.

For the analysis of the potential related costs and benefits of the proposed delegated acts for non-complex insurance-based investment products, EIOPA has applied as a baseline scenario the effect from the application of the Directive requirements in Article 30(3)(a)(ii), IDD.

E.2 - Objectives

The Commission's mandate invites EIOPA to provide technical advice on the criteria to assess "other non-complex insurance-based investment products" for the purposes of Article 30(3)(a)(ii), IDD. It is important to note that the IDD provides for a separate category of non-complex insurance-based investment products under Article 30(3)(a)(i), IDD. This section of the technical advice aims to:

1. facilitate the identification of "other non-complex insurance-based investments", such that only those products for which the risks are readily understood by customers are able to be sold by execution-only;
2. promote the consistent application of the IDD with respect to the identification of "other non-complex insurance-based investments"; and
3. be consistent with the line taken in the delegated acts expected to be adopted under Article 25(8) of MiFID II.

These aims are consistent with the objectives of IDD, which has three general objectives:

1. to improve insurance regulation in a manner that will facilitate market integration;
2. to establish the conditions necessary for fair competition between distributors of insurance products; and
3. to strengthen consumer protection, in particular with regards to insurance-based investment products.

the 'competing product' is more accurately described as an alternative channel for the distribution of the investment fund".

⁶¹ http://ec.europa.eu/finance/finservices-retail/docs/investment_products/feedback_statement_srips_en.pdf

E.3 - Policy Options

With the intention to meet the objectives set out in the previous section, EIOPA has analysed different policy options throughout the policy development process.

The section below reflects the most relevant policy options that have been considered in relation to non-complex insurance-based investment products.

Policy option 1 – Extremely restrictive criteria for “other non-complex insurance-based investments” which existing types of products, not within the scope of Article 30(3)(a)(i), would not satisfy: On the basis that insurance-based investment products are considered to be complex where the investment exposure is not limited to non-complex MiFID II financial instruments, this Option would be to effectively prevent insurance undertakings and intermediaries from distributing, via an execution-only, insurance-based investment products that are not within the scope of Article 30(3)(a)(i), IDD.

Policy option 2 – Criteria for “other non-complex insurance-based investments” based on the criteria in MiFID II for “other non-complex financial instruments” (Preferred Option): Another possibility would be only to prevent insurance undertakings and intermediaries from distributing, via an execution-only sale, “other non-complex insurance-based investments” where they do not meet criteria related to the complexity of the product, or its features, taking those defined in the draft MiFID II delegated regulation as a starting point.

Policy option 3 – Very general or otherwise limited criteria to restrict the execution-only sale of “other non-complex insurance-based investments”: This would be based on the perspective that significant discretion is needed on a national or product level to determine whether a product is complex. It would also reflect the perspective that the existing provisions in IDD, such as the “demands and needs test”, already provide adequate safeguards for customers, as well as potentially the fact that additional provisions can be introduced on a Member States level where they are judged to be necessary.

E.4 - Analysis of impacts

Option 1 – Extremely restrictive criteria for execution-only sales of IBIPs not within the scope of Article 30(3)(a)(i)

Benefits:

- **For customers:** The rationale of this option is that customers may not be able to understand the risks involved in such products. Therefore, where the conditions in Article 30(3)(a)(i), IDD are not satisfied, the distributor would be required to collect appropriate information from the customer to assess whether the insurance product is suitable or appropriate for them. In this way, provided the distributor

properly undertakes these assessments, the risk that the customer purchases a product that is not apposite for them, or not in their best interests, should be very small. Therefore, this option provides the highest level of customer protection.

- **For industry:** A very restrictive approach reduces the risk that insurance products are sold which are not in the best interests of the customer. Therefore, this would reduce the risk of mis-selling products, thereby avoiding negative impacts on the reputation of the industry, or costs to compensate customers.
- **For NCAs:** Option 1 would have the benefit of higher legal certainty for NCAs. This is because, where a product does not comply with Article 30(3)(a)(i), IDD they should not need to further assess whether its features are complex. In turn, they should also not need to assess the distributor's governance or sales processes relating to such execution-only sales. Based on this Option, NCAs would essentially only need to verify that such products were not sold via execution-only. The advantage of Option 1 is therefore that it can be relatively easily monitored and enforced.

Costs:

- **For customers:** This Option would limit the customer's choice and freedom to buy insurance-based investment products as responsible adults without the need to provide information to the distributor on their knowledge and investment experience.
- **For industry:** A very restrictive approach as proposed under Option 1, may lead to a negative impact on the business model of certain insurance undertakings and intermediaries in those Member States where insurance-based investment products can currently be sold via execution-only, and thus it may act as a restraint of trade. The costs of having to conduct at a minimum an appropriateness assessment may render certain lower cost products as less cost-efficient, or, in the extreme case, unviable. Where a distributor predominantly or exclusively sells products via execution-only, this Option is likely to have an impact on their administration costs, since they would need to modify their sales process and associated governance framework.
- **For NCAs:** Where the existing regulatory regime allows for execution-only sales, having to restrict the existing regulatory regime in this way could increase monitoring and enforcement costs for NCAs, in particular at the implementation stage.

Option 2 – Criteria for execution-sales of “other non-complex insurance-based investments” based on the comparative criteria in MiFID II

Benefits:

- **For customers:** Option 2 aims to provide an appropriate level of customer protection, while, compared to Option 1, enabling greater flexibility regarding the

means of distribution for “other non-complex insurance-based investments”. This Option, thereby, has the benefit that the overall costs of distribution should be lower for “other non-complex insurance-based investments”, and thus, in turn, these products ought to be less costly for customers.

- **For industry:** If the criteria to identify “other non-complex insurance-based investments” are effective in excluding complex products, the benefits outlined for Option 1 should also apply for Option 2 that the risk of products being mis-sold is minimised. At the same time, the benefit of Option 2 compared to Option 1 for the industry is that they would be able to continue to sell a wider range of non-complex products, or to design such products for sale, via execution-only. This means that it may be more cost efficient for them to sell non-complex products. In addition, distributors may be able to sell such products to customers who would otherwise have been deterred by the need to seek advice or provide information on their knowledge and investment experience. Therefore, this Option may have a positive impact on the sales or revenues of insurance undertakings and intermediaries.
- **For NCAs:** Option 2 will be of benefit to NCAs which do not already have rules for assessing the complexity of insurance-based investment products by establishing common principles for evaluating complexity.

Costs:

- **For customers:** In contrast to Option 1, Option 2 would enable insurance undertakings and intermediaries to offer some, but still a relatively limited, range of “other insurance-based investments”, which do not satisfy the conditions in Article 30(3)(a)(i), for sale via execution-only. Based on Option 2, depending on the current framework within the Member State, customers may be able to purchase a wider or a narrower range of products via execution-only than they are currently able to. If the criteria proposed by EIOPA result in less insurance-based investment products being available for sale via execution-only, then it can be expected that the costs of purchasing those products may increase. On the other hand, if the criteria proposed by EIOPA result in more insurance-based investment products being available, there is in theory a risk that customers may not understand the structures of those products, and as a result purchase products that are not in their best interests. However, provided that the criteria are effective in delineating between complex and non-complex insurance-based investment products, this risk should not be increased by this Option.
- **For industry:** As with the costs for customers, the costs for the industry will depend on the current framework within the Member State. This will determine whether, as a result of the criteria to identify “other non-complex insurance-based investments”, they will be able to sell a wider or a narrower range of products via execution-only than they are currently able to. If the criteria proposed by EIOPA result in less products being available for sale via execution-only, then it can be expected that the costs of distributing those products may increase. These costs would be similar to those outlined for Option 1, but would

be less in their extent. On the other hand, if the criteria proposed by EIOPA result in more products being available for sale via execution-only, there is in theory a higher risk that customers are sold products that are not appropriate for them, with in turn potential negative impacts for the reputation of the industry. However, provided that the criteria are effective in delineating between complex and non-complex insurance-based investment products, this risk should not be increased by this Option.

- **For NCAs:** Option 2 will result in costs for NCAs to verify that insurance distributors are appropriately applying the criteria. It may also result in costs for NCAs if the criteria are different from any existing rules in that Member State for the evaluation of the complexity of insurance-based investment products.

Option 3 – Very general or otherwise limited criteria to restrict the execution-only sale of “other non-complex insurance-based investments”

Benefits:

- **For customers:** This Option depends on how Member States implement the general criteria and the principle of complexity set out in the Directive or the existing national provisions. Where a wide range of products that do not satisfy the conditions in Article 30(3)(a)(i), IDD are deemed to be non-complex and are eligible for sale via execution-only, this approach may positively impact those retail customers who are highly financially literate. These customers should therefore be able to benefit from the ability to purchase a wide range of products at a lower cost. Where only a limited number, or no, products are deemed non-complex the benefits would be similar to Options 1 and 2.
- **For industry:** Option 3 is likely to provide insurance distributors with a high degree of discretion, although it would depend on the approach taken in the Member State. In this case, distributors would have greater flexibility to determine whether a particular product or product feature is non-complex, for example based on customer feedback.
- **For NCAs:** Where NCAs have more developed regimes which impose more detailed requirements already (following IMD), they are likely to retain those rules and thus benefits are not envisaged. Where NCAs do not currently have rules in this area, they will have the benefit of greater flexibility to determine the appropriate framework for the particular national market.

Costs:

- **For customers:** As stated, this option depends on how Member States implement the general criteria. In the absence of a more prescriptive approach on a national level, Option 3 entails the risk that customers are sold products which are not appropriate for them, or that they do not understand the risks of. This Option therefore heightens the risk of products being mis-sold. This is because without reasonably precise restrictions on the types of products that are

non-complex, insurance distributors may consider certain products to be non-complex, when in fact some customers are not able to understand the associated risks.

- **For industry:** In the absence of a more prescriptive approach on a national level Option 3 entails the risk of a lower level of customer protection, and thus that market participants can be expected to continue to face reputational risk due to mis-selling cases.
- **For NCAs:** In the presence of only very general or limited restrictions on what constitutes “other non-complex insurance-based investments”, it may be more difficult for NCAs to supervise and enforce the requirement that insurance undertakings or intermediaries should only distribute non-complex insurance-based investment products via an execution-only sale. However, where NCAs already have a more detailed framework these costs would not apply.

E.5 - Comparison of options

When comparing the costs and benefits of the different policy options, it became apparent that an overly strict approach would not only be disadvantageous for insurance undertakings and insurance intermediaries, but also for customers and potentially for NCAs.

As policy option 1 (extremely restrictive criteria) would contradict the principle of the customer being responsible for their decisions, and limit the customer’s flexibility in how they purchase insurance-based investment products, as well as increase regulatory costs, this Option does not seem adequate. Furthermore, it is questionable whether the Directive intends for there to be such a restrictive approach at EU level.

Conversely, policy option 3 (very general criteria) does not seem adequate either, as it does not address adequately the risk of insurance-based investment products being mis-sold due to the customer not understanding the risks involved.

Therefore, policy option 2 (criteria based on MiFID II) is considered to find the appropriate balance between the interests of insurance distributors and those of their customers. It also enables an appropriate degree of flexibility at NCA level, in providing criteria for other “non-complex insurance-based investments” at EU level which are still consistent with a minimum harmonising approach. From a customer’s perspective it seems reasonable to prevent insurance undertakings and insurance intermediaries from making insurance products available for sale via execution-only which do not meet the criteria, while enabling customers to execute an order for products if the criteria are met.