Online survey in preparation of the Call for Advice from the European Commission on the delegated acts under the Insurance Distribution Directive

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EIOPA IRSG

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* **Publication of responses**

Contributions received will be published on EIOPA's public website, please state if you agree or disagree to the publication of your answers.

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Product oversight and governance arrangements

Q1: Article 25(1)(1) IDD requires insurance undertakings and intermediaries which manufacture insurance products for sale to customers to establish specific organisational arrangements and procedures for the approval of each insurance product. From your point of view, under which circumstances should the activities of an entity (in particular of an intermediaries) be considered as manufacturing of insurance products? Could you provide examples of specific activities which you would consider as manufacturing?

When an intermediary designs a product which is targeted at a group (not individual) of clients or potential clients. By "design" means - sets/proposes/agrees the coverage requirements - including, perils to be covered, limits of indemnity, excesses, wording, warranties/exclusions and rates as appropriate. It will also involve identifying the target group. In the EU there are tens of thousands of such schemes. The approach should not be a catalogue but be principles-based to capture the effective participation of a distributor in product manufacturing. For example many brokerages have a broad range of schemes/programmes designed, targeted and managed for private motor insurance, motor trade, travel insurance for affinities (various), professional indemnity for insurance intermediaries, group life, critical illness and income continuance insurance for bank officials. Thousands of intermediaries in the EU have tens of thousands of schemes for all sorts of trades, groups, affinities, professionals both life and non-life. The vast majority of which have served and continue to serve groups and the public well without any unnecessary additional cost or bureaucracy, therefore additional rules should be targeted at problematic areas. In addition, care has to be taken to avoid to construe every bidding process organized by a broker as manufacturing.

Q2: If more than one entity is involved in the manufacturing of insurance products, how should the responsibilities of the respective entities be defined and distinguished? Should the entities be obliged to lay down their respective responsibilities in a written agreement?

When an intermediary acts as a manufacturer/product producer and does not carry the risk - of necessity an insurer is involved. The terms of any scheme designed by an intermediary have to be discussed and agreed with an insurer. Such arrangements would typically be covered by a written agreement but this should not be a formal requirement. In any case, care has to be taken to balance effectiveness of any requirement with the administrative burden.

With regard to the general responsibilities of distributors and manufacturers, each should bear their own responsibility to ensure that the end-customer

demographic of the product is as per the original design and researched target market for the product. Both manufacturers and distributors should discuss and exchange information regarding the product and target market.

The manufacturer should define the target market, while leaving the necessary flexibility to the distributor where the product is suitable/appropriate for the customer. Distributors would therefore remain responsible for meeting the required standards for distribution and determining whether such sales remain suitable/appropriate.

On the other hand, the key issue is to make clear to a client which parties are involved in the manufacturing of a certain product and what is their particular role, if this piece of information is relevant in maintaining a certain level of consumer protection. Depending of the “manufacturing process”, both insurers and intermediaries should be responsible for their own actions in front of the client. In such cases, shared responsibility might make both parties more “involved”.

Q3: According to Article 25(1)(3) IDD, the product approval process should specify an identified target market for each product and shall ensure that the intended distribution strategy is consistent with the identified target market. From your point of view, which are the essential factors and criteria to identify the target market? How should the target market be understood in the context of insurance products which are supposed to be distributed to the mass market? Should there be different levels of granularity, e.g. depending on the complexity of the insurance product?

The key factors for identification of a target market should be the relevant criteria for the (potential) customer. In addition, it should be considered, whether the target market has sufficient mass to warrant the effort required to set up a differentiated scheme, are there potential benefits by way of pricing, coverage or control (or all three) to be taken into account?

There will always different levels of granularity depending on the complexity of the target group and of the insurance product that is being distributed. Many insurance retail products (e.g. motor, household personal liability covers) have very broad target markets (with very few exceptions). The rules should not constrain the offer of such products to very broad target markets by defining an artificial minimum level of granularity.

In any case, the description of a target market must not be taken as a substitute for the demands and needs test performed by the distributor at the point of sale. The reason is, that the definition of a target market by definition deals with abstract needs of a market segment, not specific needs of the relevant customer, which are ultimately relevant for the customer fit.

Explicit recognition should be introduced to acknowledge that it remains possible generally to sell products outside of the intended target market. A rigid determination of a target market at the level of product design would lead to the exclusion of numerous customers from suitable insurance coverage, if – for different reasons – they do not form part of the target group, despite the fact that the product still meets their individual need for

protection. The distributor has to be able to deviate from the pre-set target group if this is reasonable in a particular case. The same principle was also recognised by ESMA in its technical advice to the EC on MiFID 2. In order to ensure a consistent and coherent approach, the same principle should apply here. This would leave flexibility to the distributor where the product is suitable/appropriate for the customer.

From the consumers' perspective, proportionality is key - as one can argue that a general rule on identifying target markets in this case is difficult to establish.

Q4: According to Article 25(1)(2) IDD, the product approval process should be proportionate and appropriate to the nature of the products. Would you consider it appropriate and necessary requiring manufacturers to ensure that the insurance products are fairly priced and offer added value to customers?

No. In particular, there should be no interference in a market process for price determination. The market should determine the pricing. Subjective terms like "fairly priced" should be avoided at all times. The term "added value" is less extreme but is still subjective.

Who would govern or set a benchmark for a "fair price" - a regulator? Who should the price be fair to? The consumer, the salesman, the shareholder, the prudential regulator, the government that extracts IPT? In other words, the very open-ended wording could be used to establish a de facto price control through the back door. This would be a regime change (or paradigm shift) in supervision, which at the very least would need a clear mandate on level 1.

The context of Solvency II coming into force and the requirements of the IDD itself (before the adoption of delegated acts) are more than sufficient to favorably influence both pricing and behaviour for the customer benefit.

The notion of a fair value price for insurance products is an inherently subjective one - where a product is not fairly priced, there will be no market for it as consumers will simply not purchase it. While the insurance industry supports the development of good products that bring value to customers, EIOPA should not consider interfering with companies' internal pricing mechanisms, as to do so would inevitably hamper competition.

For the overwhelming majority of insurance classes, pricing should only be one criteria among many others when deciding on buying an insurance policy and it should be left to the rules of the free market. However, care has to be taken when considering mandatory insurances which also have a social role. Paying claims on time, customer relationship, trust-building - these factors are sometimes far more important.

Q5: Which information should the manufacturer of insurance products make available to distributors (as required in Article 25(1)(5), IDD)? Should the manufacturer inform the distributors about the fair value of the insurance products, in particular with regard to insurance-based investment products?

In relation to IBIP's Manufacturers most of the relevant information including all relevant valuation information) can be expected to be included in the PRIIP KID. Additional information may depend on the product (type) and market segment. It is therefore advisable to use a broad principles-based approach instead of a specific list.

Since all relevant valuation information should be contained in the PRIIP KID, no additional “fair value” disclosure should be necessary. It should also be noted, that the term “fair value” does not have a clear definition in the insurance context.

The European Commission has been considering a cost indicator in the Key Information Document (KID) that would aggregate the investment costs and the biometric risk premium for insurance-based investment products. On the other hand, the ESAs have proposed, in their draft Regulatory Technical Standards (RTS), a cost indicator that would aggregate the investment costs and the ‘fair value’ of the biometric risk premium. However:
- neither option provides for consistency with Level 1 PRIIPs Regulation which introduces in the KID a section on costs which should include “the costs associated with an investment in the PRIIP”.
- neither option provides for meaningful comparisons for retail investors.
- neither option provides for a level playing field as insurance-based investment products will systematically appear more expensive compared to other PRIIPs.

In order to achieve meaningful information that allows comparisons between products, the investment costs and the biometric risk premium must be presented by the manufacturer in separate sections of the KID.

Manufacturers should make available to distributors the main features of the product such as risks insured and excluded, duration, coverages etc., as mentioned previously, but also make sure that the actual salesperson working for the intermediary is properly trained in order to explain the products’ characteristics to the customer itself. Proper education and training can prevent a lot of issues.

Q6: Which arrangements should the distributor have in place to obtain all relevant information on the insurance product and the product approval process? What should be the consequence if the distributor does not obtain all necessary information?

Manufacturer and distributor should provide an adequate interface to each other, which may differ substantially by product type, distribution channel, etc. In addition, the approach should be proportionate and principles-based.

In case of disputes, there should be a regular dispute resolution between manufacturer and distributor which cuts both ways if one partner does not satisfy its obligations. This is a dispute between professional parties. The conflict resolution therefore does not necessitate any specific protection for

either party as end customer protection would.

Distributors have to be responsible for becoming familiar with the product that they are offering in the same manner in which insurers have to be responsible for offering these information. It is basically a common responsibility in front of the customer. A client is not at all interested on who has to send which information to whom. The final objective is what matters, from this perspective.

Q7: According to Article 25(4), IDD the insurance undertaking shall regularly review the insurance products it offers and markets. From your point of view, what are the essential elements of this review, in particular with regard to insurance-based investment products?

The regular review should contain all relevant aspects in product manufacturing. There may be multiple aspects, e.g. change in insights on customer needs, product structure, or legal rules, which need to be covered in a self-assessment by the insurance undertaking. There review requirement should be triggered by material change not by a pre-defined frequency. While for some standard products even an annual review may overly burdensome, for other products a higher frequency seems necessary. Generally, the application should be principles-based and proportionate. There is no need to deviate from these general principles for IBIP products.

Review and monitoring mechanisms should be in place for responding to any signals received from the market that the product may no longer meet the interests, objectives and characteristics of the identified target market. However, we would be concerned over the requirement for on-going monitoring. The most important thing is for the manufacturer to have in place a strategy for responding appropriately to feedback from the target market, which will also include information received from distributors.

Conflicts of interests and inducements

Q8: According to Article 29(2), IDD, monetary and non-monetary benefits which are provided in connection with the distribution of an insurance-based investment product or an ancillary service should not have a “detrimental impact” on the quality of the relevant service to the customer. From your point of view, which criteria and methodology should be applied to assess whether a benefit has a detrimental impact on the quality of the service?

In any case, it should be noted that a detrimental impact to the customer need would have to be proven or demonstrated by some empirical evidence (not just asserted). In addition, the total effects of the compensation provided should be assessed in a comprehensive manner (i.e. including all components), using a proportionate and principles-based approach.

Q9: Please provide specific examples and cases where you would consider that benefits have a detrimental impact on the quality of service?

It is difficult to generalize, especially since the overall impact of the benefits needs to be assessed.

Q10: Are there any specific types of benefits which have detrimental impact on the quality of the service already by their nature (e.g. tickets for sports events or training classes at exotic destinations)?

This is difficult to assess, since the overall impact of the benefits on the quality of the service needs to be assessed. Generally, the impact is reduced the lower the contribution of a certain component is to the overall benefit to the distributor. The attempt to classify certain remuneration components “by their nature”, by contrast would lead to a formal classification that does not take these aspects into account. It is not clear why a ticket for a sports event by its nature poses a systematic threat that would warrant regulatory concern.

Common sense can not and should not be regulated, no matter the industry we are referring to. However, best practices can be shared among European insurers and intermediaries. Excessive and sometimes misleading schemes can be banned by involved parties.

Q11: Are there any models for calculating benefits or payment methods which you would consider detrimental on the quality of service?

See question 10.
Multi-level marketing schemes can sometimes lead to consumer detriment, as the main focus is on developing the scheme itself and not on the client.

Q12: Please provide specific examples and cases where you would consider that any risk of detrimental impact on the quality of service can be excluded?

Generally, proportionate and principles-based overall assessment of impact should apply, including consideration of possible mitigation efforts (e.g. via consideration of sales compliance rules or quality indicators in the remuneration, such as lapse rate).

Q13: From your point of view, under which circumstances do insurance intermediaries and insurance undertaking not comply with their duty to act honestly, fairly and professionally in accordance with the best interests of the customers when receiving or paying inducements (not having a detrimental impact on the quality of the service) as laid down in Article 29(2)(b), IDD?

The many undefined legal terms (e.g. “fairly”, “best interest of the customer”) may make it difficult to specify the exact duties of the distributor.

Q14: Which steps should insurance intermediaries and insurance undertakings be supposed to take in order to address and manage conflicts of interest resulting from inducements?

Intermediaries should firstly seek if possible to avoid conflicts of interest. Where it is not possible to avoid conflict of interests intermediaries should mitigate as far as possible any conflict of interest and should disclose the conflict of interest to any client or potential client.
The transparency requirements for IBIP's should address most if not all concerns in this area.

Both insurance undertakings and intermediaries should do their utmost in order to prevent conflict of interests, no matter the form in which they arise. Sales conferences in exotic places, team-building events that go well beyond a reasonable level etc. should be avoided. Remaining budgets can, in example, be diverted into training for the sales force, social responsibility programs etc.

Assessment of suitability and appropriateness

Q15: From your point of view, what are the relevant criteria to assess whether an insurance-based investment product is suitable for a customer pursuant to Article 30(1), IDD?

By conducting a demand and needs test. Other criteria which would be relevant is the "vulnerability" of the client and the terms and conditions of the product.

Q16: What is your understanding of risk tolerance and ability to bear losses in the context of Article 30(1), IDD?

“Risk tolerance” is the subjective attitude a customer takes towards risk, “ability to bear losses” concerns objective (measurable) aspects, which may be indicated by wealth or income. A demands and needs test to assess suitability should take into account both.

Q17: From your point of view, what are the relevant criteria to assess whether an insurance-based investment product is appropriate for a customer pursuant to Article 30(2), IDD?

Core criteria are included in Art. 30 (2) IDD, i.e. customer knowledge and experience. A demands and needs test to assess appropriateness should take those into account, typically by asking the customer about these aspects.

Q18: What are the relevant criteria to identify non-complex insurance-based investment product (as referred to in Article 30(3)(a)(ii), IDD)? Which insurance-based investment products would you consider as non-complex?

Complexity should not be judged based on the (internal) construction of the product but on the effective exposure of the customer.
For example, IBIP's with an unconditional underlying (apart from early encashment in whole or in part) guarantee to the capital that has been invested for the duration of the contract should be considered non-complex, even if the instruments or investment strategies used to produce such guarantees are non-trivial.

Reporting

Q19: Apart from the insurance contract (Article 30(3), IDD), the suitability statement (Article 30(4), IDD) and the periodic reports (Article 30(4), IDD), what information should the distributor be required to record?

It is important, that the customer receives relevant information, which may depend on the product and/or the situation. In addition, unnecessary or confusing disclosure of very similar information should be avoided (e.g. by overlapping application of EU and national reporting requirements). Also, the update of pre-contractual information (such as the PRIIPs KID) should not be necessary.

Q20: What is the relevant information which should be included in the insurance contract (Article 30(3), IDD), the suitability statement (Article 30(4), IDD) and the periodic reports (Article 30(4), IDD)?

The insurance contract should contain the legal conditions of the contract between customer and insurance undertaking. The suitability statement should document aspects of advice and recommendation (both regarding input and result), The periodic reports should contain relevant changes in information for the customer (based on the scope agreed between customer and insurer/intermediary).

Q21: At what frequency should periodic reports (Article 30(4), IDD) be provided to the customers and what information at a minimum should be contained in the reports?

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Typically, annually, but may differ based on product. The details should be
mostly left to national transposition to reflect product specifics.
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