EIOPA-BoS-14/150

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Consultation Paper on the proposal for Guidelines on product oversight & governance arrangements by insurance undertakings

EIOPA – Westhafen Tower, Westhafenplatz 1 - 60327 Frankfurt – Germany - Tel. + 49 69-951119-20;
Fax. + 49 69-951119-19; site: www.eiopa.europa.eu

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Responding to this paper

EIOPA welcomes comments on the Guidelines on product oversight & governance arrangements for insurance undertakings.

The consultation package includes:
- Consultation Paper
- Template for comments

Please send your comments to EIOPA in the provided Template for Comments, by email CP-14-039@eiopa.europa.eu , by 23 January 2015.

Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be processed.

EIOPA invites comments on any aspect of this paper. Comments are most helpful if they:
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with EIOPA's rules on public access to documents[1]. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by EIOPA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.eiopa.europa.eu under the heading 'Legal notice'.

[1] Available at https://eiopa.europa.eu/fileadmin/tx_dam/files/aboutceiops/Public-Access-(EIOPA-MB-11-051).pdf.

Consultation Paper Overview & Next Steps

EIOPA carries out consultations in the case of Guidelines and Recommendations in accordance with Article 16(2) of the EIOPA Regulation.

This Consultation Paper is being issued to consult the public on a proposal for Guidelines on product oversight & governance arrangements by insurance undertakings.

This Consultation Paper presents the draft Guidelines and the explanatory text.

The analysis of the expected impact from the proposed policy is covered under the Annex I (Impact Assessment).

Next steps

EIOPA will consider the feedback received and expects to publish a final report on the consultation and to submit the Guidelines for adoption by the Board of Supervisors in Q2 2015.

Guidelines

Introduction

1.1. These Guidelines were developed according to Article 16 of Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (hereinafter "EIOPA Regulation")[2] and taking into account Recital 16, Articles 40 and 41 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")[3] that provide for the following:

- *"The main objective of insurance and reinsurance regulation and supervision is the adequate protection of policyholders and beneficiaries….."*[4],
- *"Member States shall ensure that the administrative, management or supervisory body of the insurance or reinsurance undertaking has the ultimate responsibility for the compliance, by the undertaking concerned, with the laws, regulations and administrative provisions adopted pursuant to this Directive"*[5],
- *"Member States shall require all insurance and reinsurance undertakings to have in place an effective system of governance which provides for sound and prudent management of the business"*[6].

1.2. These Guidelines are addressed to competent authorities. Notwithstanding the explicit references to manufacturers or distributors, this document is not be read as imposing any direct requirements upon those financial institutions. Financial institutions are expected to comply with the supervisory or regulatory framework applied by their competent authority.

Scope

1.3. Product oversight and governance arrangements refer to internal processes, functions and strategies aimed at designing and bringing products to the market, monitoring and reviewing them over their life cycle. The arrangements need to contain steps to, at least, (i) identify a target market for which the product is considered appropriate, (ii) identify market segments for which the product is not considered appropriate, (iii) carry out product analysis to assess the expected product performance in different stressed scenarios, (iv) carry out product reviews to check if product performance is leading to consumer detriment and, in case this occurs, take actions to change its characteristics and minimise the detriment, (v) identify the relevant distribution channels taking into account the characteristics of the target market and of the product, and (vi) verify that distribution channels act in compliance with the manufacturer's product oversight and governance arrangements.

[2] OJ L 331, 15.12.2010, p. 48.
[3] OJ L 335,17.12.2009, p.1.
[4] Recital 16 of Solvency II
[5] Article 40 of Solvency II
[6] Article 41(1) first para of Solvency II

1.4. Product oversight and governance arrangements could be part of the system of governance within the manufacturer. However, implementing product oversight and governance arrangements is not be understood as introducing a new mandatory key function nor are they necessarily linked with the risk management, internal audit, actuarial or compliance functions prescribed by Solvency II. Still, the administrative, management or supervisory body of insurance undertakings is responsible for the establishment and subsequent reviews of the product oversight and governance arrangements.

1.5. Product oversight and governance arrangements are complementary to point of sale disclosure requirements, namely a manufacturer proactively disclosing, a description of the main characteristics of the product, its risks (where relevant e.g. for insurance-based investment products), the total price of the product to be paid by the consumer, including all related fees, charges, and expenses.

1.6. Product oversight and governance arrangements need to be proportionate to the level of complexity of the products as well as the nature, scale and complexity of the relevant business of the manufacturer.

1.7. These Guidelines cover arrangements that apply to manufacturers of insurance products, namely insurance undertakings. It is not intended to cover reinsurance undertakings or distributors of insurance products. EIOPA may develop separate guidelines on product oversight and governance arrangements for distributors of insurance products in a second phase once a suitable legal basis is available under future EU legislation.

1.8. Competent authorities may wish to consider applying the requirements for manufacturers to distributors who are involved in the design or manufacture of an insurance product.

1.9. Competent authorities may wish to consider extending the definition of consumer to capture other types of customers such as micro-enterprises and small and medium-sized enterprises (SMEs).

1.10. In applying these Guidelines, competent authorities need also give due consideration, where relevant, to Section II of EIOPA's Preparatory Guidelines on the System of Governance under Solvency II[7], future Guidelines on the System of Governance under Solvency II as well as EIOPA's Guidelines on Complaints-Handling by Insurance Undertakings[8].

Definitions

1.11. For the purpose of these Guidelines, the following definitions have been developed:

- *Manufacturer* means an insurance undertaking that designs and brings to the market, products to be offered to consumers.

[7] Available at https://eiopa.europa.eu/publications/eiopa-guidelines-new/guidelines-on-system-of-governance/index.html.
[8] Available at https://eiopa.europa.eu/publications/eiopa-guidelines/index.html.

- *Target market* means the group(s) of consumers for whom the manufacturer is designing the product.

- *Consumer* means a natural person, who is acting for purposes which are outside of his/her trade, business or profession.

- *Distributor* means a person who offers the product to consumers, including business units of manufacturers which are not involved in the designing of the product, but are responsible for bringing the product to the market.

- *Products* means the classes of non-life insurance and life insurance listed in Annex I and Annex II of Solvency II.

- *Insurance-based investment product* means insurance based investment product as defined in Article 2 (13) of Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation (consolidated version)[9].

1.12. If not defined in these Guidelines, the terms have the meaning defined in the legal acts referred to in the introduction.

[9] OJ L 9, 15.1.2003, p. 3.

Guideline 1 - Establishment of product governance and oversight arrangements

The manufacturer should establish and implement product oversight and governance arrangements. Those arrangements should be designed to minimise potential consumer detriment, provide for a proper management of conflicts of interests and should ensure that the interests, objectives and characteristics of consumers are duly taken into account.

The manufacturer should set out the product oversight and governance arrangements in a written document, endorsed by the manufacturer's administrative, management or supervisory body and made available to all relevant staff.

Guideline 2 - Role of the manufacturer's administrative, management or supervisory body

The manufacturer's administrative, management or supervisory body should be ultimately responsible for the establishment, implementation, subsequent reviews and continued internal compliance with the product oversight and governance arrangements.

Guideline 3 - Review of product governance and oversight arrangements

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

Guideline 4 – Management of conflicts of interest in product design

The manufacturer should implement and should establish procedures to ensure that the design of the product complies with the requirements relating to the proper management of conflicts of interest.

Guideline 5 – Target market

The manufacturer should include in its product oversight and governance arrangements, suitable steps in order to identify the relevant target market of a product.

The manufacturer should also identify the groups of consumers for which the product is considered likely not to meet their interests, objectives and characteristics.

The manufacturer should only design and bring to the market, products with features, charges, risks and distribution channels that meet the interests, objectives and characteristics of, and are of benefit to the identified target market.

When deciding whether a product meets the interests, objectives and characteristics or not of a particular target market, the manufacturer should consider assessing the level of information available to the target market and the degree of financial capability of the target market.

Guideline 6 – Knowledge and ability of staff involved in the design of products

The manufacturer should ensure that any staff tasked with designing a product following the manufacturer's product oversight and governance arrangements should be fit and appropriately trained in order to understand the product's main features and characteristics as well as the interests, objectives and characteristics of the target market.

Guideline 7 - Product testing

Before a product is designed and brought to the market, or is offered to a new target market, or changes to an existing product are introduced, the manufacturer should conduct appropriate testing of the product and scenario analyses, in order to be able to assess the product under an appropriate range of scenarios. The scenario analysis should assess if the scenarios' results meet the objectives for the defined target market over the life span of the product.

Manufacturers should make appropriate product changes before the launch, where the scenario analysis gives rise to poor results for the target market.

The manufacturer should carry out product testing in a qualitative and, where appropriate, in a quantifiable manner depending on the type of product that will be tested.

Guideline 8 - Product monitoring

Once the product is distributed, the manufacturer should monitor on an on-going basis that the product continues to meet the interests, objectives and characteristics of the identified target market.

Guideline 9 - Remedial action

In case the manufacturer identifies a problem after designing and bringing products to the market or after carrying out product monitoring as requested in Guideline 8, the manufacturer should take appropriate action to mitigate the situation and prevent the re-occurrence of detriment.

The manufacturer should also take any necessary action in case a problem with the product has already materialised and it has not been discovered after the regular product monitoring process.

The manufacturer should notify any relevant remedial action promptly to the distributor involved and to the consumer in case of direct sales including information on changes or modifications to the product.

Guideline 10 - Distribution channels

The manufacturer should select distribution channels that are appropriate for the target market.

The manufacturer should select distribution channels that have the appropriate knowledge to correctly place/distribute each product on the market and to give the proper information and/or advice to the consumer.

The manufacturer should provide information, including the details of the products to distributors, of an adequate standard, which is clear, precise and up-to-date.

The information given to distributors should be sufficient to enable them to:

a) understand and place the product properly on the target market,

b) identify the target market for which the product is designed and also to identify the group of consumers for which the product is considered likely not to meet their interests, objectives and characteristics,

c) meet any other obligations under already applicable European legislation vis-a-vis the target market and especially to extract the relevant information that needs to be communicated to the consumer.

The manufacturer should take all reasonable steps to ensure that distribution channels act in compliance with the objectives of the manufacturer's product oversight and governance arrangements.

The manufacturer should verify, on a regular basis, that the product is distributed to consumers belonging to the relevant target market.

When the manufacturer considers that the distribution channel does not meet the objectives of the manufacturer's own product oversight and governance arrangements, the manufacturer should take remedial actions towards the distribution channel.

Guideline 11 - Outsourcing of the product design

The manufacturer should retain full responsibility for compliance with product oversight and governance arrangements as described in these Guidelines when they designate a third party to design products on their behalf.

The manufacturer should not outsource the product design in such a way as to lead to undermining continuous and satisfactory service to the target market.

Guideline 12 - Documentation of product governance and oversight arrangements

All relevant actions taken by the manufacturer in relation to the product oversight and governance arrangements should be duly documented and kept for audit purposes and made available to the competent authorities upon request.

Compliance and Reporting Rules

1.13. This document contains Guidelines issued under Article 16 of the EIOPA Regulation. In accordance with Article 16(3) of the EIOPA Regulation, competent authorities shall make every effort to comply with guidelines and recommendations.

1.14. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.

1.15. Competent authorities shall confirm to EIOPA whether they comply or intend to comply with these Guidelines, with reasons for non-compliance, by two months since the date of their publication.

1.16. In the absence of a response by this deadline, competent authorities will be considered as non-compliant to the reporting and reported as such.

Final Provision on Reviews

1.17. The present Guidelines shall be subject to a review by EIOPA.

Explanatory text

Guideline 1 - Establishment of product governance and oversight arrangements

The manufacturer should establish and implement product oversight and governance arrangements. Those arrangements should be designed to minimise potential consumer detriment, provide for a proper management of conflicts of interests and should ensure that the interests, objectives and characteristics of consumers are duly taken into account.

The manufacturer should set out the product oversight and governance arrangements in a written document, endorsed by the manufacturer's administrative, management or supervisory body and made available to all relevant staff.

1.18. This does not necessarily require that new or fully separate arrangements are drafted; it can be sufficient to refer to existing documents where these contain the relevant information and just record additional information if and insofar as this is necessary. The manufacturer may combine written arrangements as it sees fit in line with its organisational structure and processes.

1.19. A proper implementation of written arrangements requires ensuring that all relevant staff members are familiar with and observe these arrangements for their respective area of activities. It also requires that any changes to the arrangements are promptly communicated to them.

Guideline 2 - Role of the manufacturer's administrative, management or supervisory body

The manufacturer's administrative, management or supervisory body should be ultimately responsible for the establishment, implementation, subsequent reviews and continued internal compliance with the product oversight and governance arrangements.

1.20. The manufacturer's administrative, management or supervisory body ensures that the product oversight and governance arrangements are appropriately designed and implemented into the governmental structures of the manufacturer.

1.21. The manufacturer's administrative, management or supervisory body can consider involving any relevant key functions in the establishment and subsequent reviews of the product oversight and governance arrangements.

1.22. The product oversight and governance arrangements as well as any changes are subject to prior approval by the manufacturer's administrative, management or supervisory body.

Guideline 3 - Review of product governance and oversight arrangements

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

1.23. To this end, a minimum frequency for regular review and updates is to be established. In addition, relevant factors are to be identified which – once they occur – could trigger an ad hoc review of the product oversight and governance arrangements. Such factors could be, for example, significant changes in the retail strategy, changes in the complexity of the product lines and changes in the distribution channels.

1.24. Any review of the product oversight and governance arrangements has to be appropriately documented. The documentation needs to record who conducted the review and to include any suggested recommendations and the decisions subsequently taken by the manufacturer's administrative, management or supervisory body in respect of those recommendations as well as the reasons for them.

Guideline 5 – Target market

The manufacturer should include in its product oversight and governance arrangements suitable steps in order to identify the relevant target market of a product.

The manufacturer should also identify the groups of consumers for which the product is considered likely not to meet their interests, objectives and characteristics.

The manufacturer should only design and bring to the market, products with features, charges, risks and distribution channels that meet the interests, objectives and characteristics of, and are of benefit to the identified target market.

When deciding whether a product meets the interests, objectives and characteristics or not of a particular target market, the manufacturer should consider assessing the level of information available to the target market and the degree of financial capability of the target market.

1.25. To identify the target market, manufacturers could consider the following:

(i) tax status implications for different products;
(ii) level of risks of the product to be designed;
(iii) liquidity accessibility;
(iv) demographic factors;
(v) level of knowledge and understanding of the complexity of the product;
(vi) financial capability.

1.26. For instance, the claims ratio or cause of complaints could be used as a tool to assess whether certain products are of benefit to consumers.

1.27. Moreover, in certain cases it may be rather obvious for whom the product would not suitable (e.g. a life insurance policy running for 30 years for a 97 year old woman). Therefore identifying for whom the product may not be suitable is helpful in order to get a clear picture of the boundaries of the target market,

Guideline 6 – Knowledge and ability of staff involved in the design of products

The manufacturer should ensure that any staff tasked with designing a product following the manufacturer's product oversight and governance arrangements should be fit and appropriately trained in order to understand the product's main features and characteristics as well as the interests, objectives and characteristics of the target market.

1.28. In this context, the requirement for staff to be fit and appropriately trained is derived from the concept of fit and proper requirements for persons who effectively run the undertaking or have other key functions as stipulated in Art. 42 (1) (a) Solvency II.

Guideline 7 - Product testing

Before a product is designed and brought to the market, or is offered to a new target market, or changes to an existing product are introduced, the manufacturer should conduct appropriate testing of the product and scenario analyses, in order to be able to assess the product under an appropriate range of scenarios. The scenario analysis should assess if the scenarios' results meet the objectives for the defined target market over the life span of the product.

Manufacturers should make appropriate product changes before the launch, where the scenario analysis gives rise to poor results for the target market.

The manufacturer should carry out product testing in qualitative and, where appropriate, in quantifiable manner depending on the type of product that will be tested.

1.29. The wideness 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.

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

- What if assumptions change? For instance, market conditions deteriorate?

1.30.1. 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 consumer terminates early the contract?

1.30.2. 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 mortality rate increases, or technical interest rate increases?
- Does the benefit cover sufficiently future needs of beneficiary?

1.30.3. In the case of a 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 claims payment policy suggest that the product is of benefit to consumers?
- 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 consumers 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 consumers?

1.30.4. The manufacturer of an insurance-based investment product will in the future 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 should cover a large range of factors that determine the performance of the product.

Guideline 8 - Product monitoring

Once the product is distributed, the manufacturer should monitor on an on-going basis that the product continues to meet the interests, objectives and characteristics of the identified target market.

1.31. As part of the product monitoring process, the manufacturer takes into account for example the level of the claims ratio for the product as well as claims payment policy or causes of complaints in determining whether to revise the offering.

Guideline 9 - Remedial action

In case the manufacturer identifies a problem after designing and bringing products to the market or after carrying out product monitoring as requested in Guideline 8, the manufacturer should take appropriate action to mitigate the situation and prevent the re-occurrence of detriment.

The manufacturer should also take any necessary action in case a problem with the product has already materialised and it has not been discovered after the regular product monitoring process.

The manufacturer should notify any relevant remedial action promptly to the distributor involved and to the consumer in case of direct sales including information on changes or modifications to the product.

1.32. 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 (in terms of detriment to the consumer) from what the manufacturer originally expected.

1.33. As a general rule, 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 consumer to which the product has been sold already.

Guideline 10 - Distribution channels

The manufacturer should select distribution channels that are appropriate for the target market.

The manufacturer should select distribution channels that have the appropriate knowledge to correctly place/distribute each product on the market and to give the proper information and/or advice to the consumer.

The manufacturer should provide information, including the details of the products to distributors, of an adequate standard, clear, precise and up-to-date.

The information given to distributors should be sufficient to enable them to:

d) understand and place the product properly on the target market,

e) identify the target market for which the product is designed and also to identify the group of consumers for which the product is considered likely not to meet their interests, objectives and characteristics,

f) meet any other obligations under already applicable European legislation vis-a-vis the target market and especially to extract the relevant information that needs to be communicated to the consumer.

The manufacturer should take all reasonable steps to ensure that distribution channels act in compliance with the objectives of the manufacturer's product oversight and governance arrangements.

The manufacturer should verify, on a regular basis, that the product is distributed to consumers belonging to the relevant target market.

When the manufacturer considers that the distribution channel does not meet the objectives of the manufacturer's own product oversight and governance arrangements, the manufacturer should take remedial actions towards the distribution channel.

1.34. The manufacturer's information to the distributor does not seek to substitute the specification of the demands and needs of a specific consumer and the underlying reasons for any advice given by the distributor according to Article 12(3) of Directive 2002/92/EC.

1.35. The manufacturer needs to also inform the distributors about the manufacturer's product oversight and governance policy and its objectives. For example, the manufacturer informs the distributor about who is the target market that the product has been designed for.

1.36. Manufacturers could survey a number of consumers to find out if they understood the product features and to see if they fit into the target market. If they do not, then the manufacturer needs to consider what this means – is its information material adequate? Is it providing enough information to distributors? Is it working right with the distributors?

1.37. If the manufacturer identifies problems with the selected distribution channels, (i.e. when the distributor is offering the product to consumers for which it is not adapted) they need to take appropriate actions.

Annex I: Impact Assessment

1. Procedural issues and consultation of interested parties

As per Article 16(2) of the EIOPA Regulation, any guidelines developed by EIOPA shall be accompanied by an annex setting out an Impact Assessment (IA) which analyses 'the potential related costs and benefits' of the proposals.

This Impact Assessment document presents the key policy questions and the associated policy options considered in developing the draft guidelines on product oversight and governance arrangements by insurance undertakings.

The content of this Impact Assessment document was considered and developed by the EIOPA Committee on Consumer Protection and Financial Innovation (CCPFI).

EIOPA benefitted from the insights of its Members regarding their experience with product oversight and governance issues. Where relevant, references to these findings are made throughout this Impact Assessment.

The draft guidelines, its annexes and its impact assessment are envisaged to be subject to a public consultation.

2. Problem definition

In recent years consumers across Europe have been confronted with financial products that did not meet their expectations, notably because of flaws in the products and/or flaws in the selling process.

In particular, the insurance industry has evolved to design products aimed at purposes beyond mere risk coverage e.g. investment and money saving. As a consequence, insurance products and contracts tend to be more complex and cover risks that may not be easily perceived by the average consumer.

Moreover, some product manufacturers designing the products may not give proper consideration to the needs of their target market, which may lead to consumer detriment.

There have been concrete cases of consumer detriment due to poor product design and/or insufficient product governance in the past e.g. in CZ, ES, FR, HU, IE, IT, LT, NL, SE and UK[10].

This reflected in the confidence in financial institutions and financial products across the sector. Defective products may also affect financial stability if sold on a mass scale. A proper mix of adequate regulatory framework and supervision, healthy competition, financial education, and a focus on consumer needs by financial institutions is needed to restore consumer confidence and with it the effective functioning of financial markets.

[10] For further details please refer to Annex 1.

Supervision of insurance products plays a special role for consumers' protection. It is one of the key areas supervisors need to focus on. From that supervisory perspective, consumer detriment caused by the purchase of unsuitable and/or poorly designed products can be addressed, among other as follows: i) ex post by product interventions or banning of products causing consumer detriment or ii) ex ante by addressing the product design process and selling practices.

The EIOPA guidelines on product oversight and product governance try to target the product design and put forward requirements for manufacturers of insurance products. These requirements could be seen as a good way of avoiding the recourse to further actions by the regulator, but if necessary do not hinder national competent authorities to use this power as well.

Another point of view to be considered is the current differences in the supervisory approaches on product oversight and governance. Only four NCAs[11] have applicable measures in place at national level while five other jurisdictions have certain related measures in place or are planning to implement some[12]. 16 NCAs reported not having any measures in place.

In summary, this analysis can be visualised as follows:

Drivers	
Lack of proper consideration of the needs and interest of consumers Poor product design	Differences in supervisory and/or regulatory approaches

Problems	
Consumer detriment	Differences in level of consumer protection

Baseline scenario

Without an intervention by EIOPA, the following scenarios may occur or the probability of occurrence may increase:

- Based upon certain national experiences, there is the possibility that insurance products are sold without advice ('non advised sales')For this reason, appropriate analysis and consideration of the target market by the

[11] IE, UK, NL. PT has already some measures in place (recommendations applicable to payment protection insurance included in a Guideline/"Circular") and is also currently considering implementing general (irrespectively of the insurance product) binding measures (a draft decree-law was recently submitted to public consultation).
[12] DK, FR and IT have some measures in place; MT and EE were considering implementing/expanding existing measures.

manufacturer when developing a product becomes even more important in order to meet the interest of the consumers and in order to avoid mis-selling.

- The differences in supervisory approaches may potentially provide scope for regulatory arbitrage across Europe.

- Finally, in the absence of follow-up action from EIOPA to the ESAs Joint position and while this matter is being addressed by ESMA and EBA[13], there is also potential for the coexistence of different regulatory / supervisory approaches in the three financial sectors.

Mandate given to EIOPA

The Joint Committee (JC) published a Joint Position of the ESAs on Manufacturers' Product Oversight & Governance Processes in November 2013 (Joint Position). It contains a set of high-level, cross-sectoral principles on financial institutions' internal product approval process. The objective was to enhance consumer protection, by strengthening the process controls by manufacturers before product launch and thus, discouraging products and services that may cause consumer detriment from reaching the market.

The principles cover all three financial sectors but were not addressed to competent authorities or financial institutions. It has been envisaged that each ESA would develop more detailed provisions, directed at financial institutions and/or competent authorities, for their respective sector [14].
Consequently, the Joint Position constitutes the baseline for the preparation of the present document by EIOPA as it is the formal mandate to the three ESAs to draft product governance principles.

[13] Regarding the work done in respect of the other sectors of the market:
- Directive 2014/65/EU (MIFID II) includes product governance and oversight requirements for investment firms, prior to the launch of products and services. These requirements must be further developed via a delegated act from the European Commission. ESMA is currently working on a technical advice containing a proposal to the Commission, on how product oversight and governance requirements could be further developed in the delegated act. ESMA has taken the Joint Position as a reference to carry out this work. This document has been subject to a public consultation and, ESMA is now analysing the relevant responses and considering whether any changes might need to be introduced, in light of the comments received and, prior to the submission of the final technical advice to the Commission.
- EBA recently started to work on product governance principles. This piece of work has been running in parallel with the work done at EIOPA. EIOPA and EBA have been following a consistent approach keeping in mind the particularities of the banking and insurance sectors, respectively. To that end, EBA and EIOPA have been in close contact during the entire drafting process.

[14] In the case of EIOPA, the Joint Position specified the following: "For EIOPA, product governance provisions may be included in the Insurance Mediation Directive (IMD1) or any future legislative act replacing IMD1. In addition, Recital 16 of Solvency II sets out the main objective of insurance and reinsurance regulation and supervision, which is the "adequate protection of policyholders and beneficiaries". This general principle is supplemented by additional requirements in Articles 41(1) and 46(1), which include having effective systems of internal control and governance to provide for sound and prudent management of the business".

3. Objective pursued

The objectives of these guidelines are:

Objective 1: to establish consistent, efficient and effective supervisory practices within the Member States with respect to internal product oversight and governance arrangements by manufacturers, taking account of the principles developed by the Joint Committee of the three ESAs.

Objective 2: to prevent miss-selling of insurance products due to poor product design.

These objectives are consistent with the following general and specific objectives of Solvency II:

- Enhancing policyholder protection.
- Encouraging cross-sectoral consistency.

Product oversight and governance requirements request financial institutions to establish a set of processes and strategies aimed at designing, operating and bringing products to the market that meet the interest, objectives and characteristics of a defined target market. It also mandates reviewing the products once launched, in order to verify that they are performing as expected and delivering the expected outcome to consumers during the whole product cycle.

Product governance is not the same as product intervention, though both are aimed at e.g. preventing consumer detriment. In brief, product governance is taken by the industry mostly prior to the launch and distribution of a product to consumers. Product intervention may be described as an action taken by a supervisory authority to restrict the marketing/placement/distribution of a product that poses risks to consumers or, if the risks have not yet materialised, when there is sufficient body of evidence proving that detriment might soon emerge. Product intervention concerns, thus, the competence of supervisory authorities to intervene in the markets in a way as to restrict and limit a distribution/placement or marketing of a product when there are serious doubts about the results those products are delivering.

Nothing in these Guidelines, neither in the scope of product intervention powers, can be seen as a product pre-approval capacity by the competent authorities.

EIOPA is of the opinion that good product governance standards, if effectively applied and enforced, would reduce the need of recourse to product intervention.

4. Policy options

During the drafting process the following policy issues were identified and different options considered:

Policy issue 1: Choice of appropriate legal instrument

MIFID II includes product oversight and governance requirements for investment products and services to be further developed by a delegated act of the Commission. ESMA is currently preparing a technical advice to the Commission that would form the basis of the delegated act. EBA is also working on a set of requirements for manufacturers and distributors of banking products, soon to be issued under the legal form of Guidelines. Although Guidelines are not binding, they represent a legal instrument the ESAs can issue in order with a view to establish consistent, efficient and effective supervisory practices and/or to ensure the common, uniform and consistent application of Union law. The comply or explain mechanism allows for public disclosure for stakeholders and a peer review on the application of the guidelines across members states.

The options of legal instruments adopted for the other financial sectors were taken into consideration when deciding the legal instrument to be chosen by EIOPA in order to achieve the objective described above to avoid an uneven level playing field between the different financial sectors.

Three options were discussed:

Option 1: not to issue any instrument and wait for IMD 2

Option 2: issue the requirements under the form of opinion or best practices

Option 3: issue the requirements under the form of Guidelines

Policy issue 2: Choice of addressees

Product oversight and governance arrangements refers to the set of actions impacting over the life cycle of financial products, from the design to the distribution to end customers and relating to any post-sale review of the product to identify any problems. Product oversight entails a series of responsibilities that are undertaken by both the manufacturer of the product (an insurance undertaking) and the distributor (an insurance undertaking or an insurance intermediary).

Different product governance and oversight requirements prepared at EU level acknowledge this distinction of responsibilities and, therefore, include a series of requirements to be followed by both types of addressees (manufacturers and distributors):

- MIFID II includes product oversight and governance requirements for investment products and services. Those principles are to be further developed by the Commission via a delegated act.

- Regarding the banking sector, EBA is also working on principles for both manufacturers and distributors of banking products.

Considering that the IMD2 text is currently being discussed, in the insurance sector, there is no clear legal basis covering mere distribution activities (carried out by insurance undertakings and/or insurance intermediaries)

Regarding the addressees of the requirements three options were considered:

Option 1: addressing the requirements to both manufacturers and distributors

Option 2: addressing the requirements to both manufacturers and distributors of insurance-based investment products

Option 3: addressing the requirements only to manufacturers

Option 3 was the only one admissible from a legal point of view, therefore options 1 and 2 were rejected early in the process.

Policy issue 3: Definition of consumer

The EIOPA Guidelines on Product Oversight and Governance arrangements by insurance undertakings apply to the development of products or services that are predominantly targeted at "consumers" in the insurance sector (which are clients / customers of insurance undertakings or of insurance intermediaries). Taken into consideration the EU legal framework referring to consumer protection, the classic definition of consumer only includes natural persons. However, small and medium-sized enterprises (SMEs) and other legal persons acting outside the scope of their business capacity could also be addressed within the target market.

Therefore, various options were examined, for the purposes of the Guidelines:

Option 1: to define and limit consumer (and therefore the persons to be considered as the target market) to natural persons acting outside their trade, profession or business; i.e. SMEs would be excluded from the scope

Option 2: to define and limit consumer to natural persons acting outside their trade, profession or business and also capture SMEs

Option 3: to define consumer as natural persons acting outside their trade, profession or business but to grant the possibility to competent authorities to extend the definition and, therefore, the persons that could be considered within the target market, without further specifying in the Guidelines

Option 4: not to define consumer neither to be specific on the type of legal or natural persons that is included within the target market.

Option 4 was immediately rejected since the Joint Position used consumer as a define term and the work done at EBA and ESMA also defines the type of person that can be included within the target market.

Policy issue 4: Need for including requirements for scenario analysis

Product governance requirements ask manufacturers to define a target market, and to 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 to assess how the product would function in different scenarios, including stressed scenarios. The conditions and method applied to scenario testing are the responsibility of the manufacturer. It can be argued that these differ depending on the type of product that will be manufactured or reviewed.

Various options were examined:

Option 1: not to require any product monitoring or scenario analysis

Option 2: to only require quantitative scenario analysis for life insurance

Option 3: to require both quantitative and qualitative scenario analysis for life insurance

Option 4: to require both quantitative and qualitative scenario analysis for both life and non-life insurance

Policy issue 5: Frequency of review process

Any internal process should be reviewed periodically in order to assess the permanence of the attitude and capability to reach its objectives. A
In light of this, the arrangements established on product oversight and governance should be reviewed as well to ensure that they are still valid and up to date and amended where appropriate.

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

Option 1: use the same frequency of Solvency II (at least according to art. 41 of Solvency II Directive, annually);

Option 2: do not specify the frequency at all.

Policy issue 6: Responsibility of the AMSB on the establishment of POG arrangements and involvement of relevant key functions

The Guidelines identify the administrative and management or supervisory body (AMSB) of an insurance undertaking as the ultimate responsible for the establishment, subsequent reviews and continued internal compliance with the system of governance requirements and therefore as well with the product oversight and governance arrangements. No other options were considered on this particular aspect.

Nevertheless, regarding the particular role of the key functions, three options were examined:

Option 1: to specify that certain functions (specifically compliance and risk management functions) should be involved in the product oversight and how they should carry out their tasks;

Option 2: to specify that certain functions (specifically compliance and risk management functions) should be involved in the product oversight without specifying their role and tasks;

Option 3: not to provide any rule regarding the role of the key functions.

Policy issue 7: Proportionality principle versus differentiation between insurance classes of business

The Joint Position was preceded by the consideration that ESAs will take into account the principle of proportionality and the type(s) of product, financial instrument or service. The guidelines' impact on manufacturers will differ depending on their size (level of the undertaking), on their type of business (product level) and also depending on the risks inherent in the product. Products in insurance are quite heterogeneous, in particular their complexity varies (example: general liability insurance vs. with-profit life insurance). Thus the question arose whether the guidelines 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.

Summary of options considered:

Option 1: to elaborate the Guidelines further and differentiate between insurance business classes within the EIOPA Guidelines

Option 2: not to differentiate between insurance business classes and only mention the applicability of the principle of proportionality in general.

Option 3: not to differentiate between insurance business classes, mention the applicability of the principle of proportionality and give supervisors and insurance undertakings some guidance on details of applicability of the principle of proportionality for product and governance processes.

Policy issue 8: Need for a specific Guideline 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 requirements of the guidelines for the outsourced process.

The following options were considered:

Option 1: specific Guideline when product design is being outsourced; meaning that the AMSB of the manufacturer stays ultimately responsible regardless of the outsourcing

Option 2: no specific Guideline; meaning that the responsibility for applying the requirements is not especially described in case of outsourcing.

5. Analysis of impacts

Policy issue 1: Choice of appropriate legal instrument

Three options were discussed:

Option 1: not to issue any instrument and wait for IMD 2

Benefits:
- for industry: a better timing regarding the implementation of requirements resulting from Solvency II and POG Guidelines is possible for EIOPA: resources could be dedicated to other projects.
- for NCAs: more certainty regarding the legal hook.

Costs:
- for consumers: risk of consumer detriment due to mis-selling of inappropriate products.
- for industry: reputational risk due to reduced credibility in case of mis-selling.
- for EIOPA: reputational risk due to divergence of supervisory practices and creation of un-level playing field.
- For NCAs: reputational risk due to inactivity in respective field.

Option 2: issue the requirements under the form of opinion or best practices

Benefits:
- for consumers: less risk of mis-selling.

Costs:
- for consumers: risk of consumer detriment due to mis-selling of inappropriate products; lower than under Option 1 but still persistent.
- for EIOPA: reputational risk due to divergence of supervisory practices and creation of un-level playing field as best practices could be implemented by industry in a non-harmonised manner or not followed at all; lower than under Option 1 but still relevant.
- for NCAs: reputational risk due to ineffective way of addressing the matter as best practices could be implemented by industry in a non-harmonised manner or not followed at all; lower impact than under Option 1 but still relevant.

Option 3: issue the requirements under the form of guidelines

Benefits:
- for consumers: risk of mis-selling minimised (high/medium benefit).

- for the industry: consumer confidence in financial products is strengthened (high benefit).
- for EIOPA and the society as a whole: harmonised set of requirements related to manufacturers ensures consistent supervisory practices across Europe and level-playing field also across-sectors(high benefit).

Costs:
- for NCAs: costs associated with implementing the guidelines (high costs).
- for industry: costs associated with implementing and following of provisions applicable at national level as well as additional administrative burden as a result thereof (high costs); competition disadvantages for small/medium-sized insurance undertakings as they may find it difficult to come up with the technical and financial resources necessary for POG compliance and therefore drop out of certain lines of business (medium costs); the new POG requirements may give way to a rise of the outsourcing of product design for various reasons, financial and legal (medium costs).
- for consumers: costs associated with the new requirements are likely to be passed on to them, so prices could go up (high/medium cost).

Policy issue 2: Choice of addressees and legal basis

Since option 3 was the only legally admissible option, options 1 and 2 are not further discussed.

Option 3: Addressing the principles only to manufactures

Benefits:
- for consumers: lower risk of mis-selling; overall quality of products is expected to improve due to early the involvement of consumer interests into the development of the product.
- for NCAs: additional powers for supervisors allowing ex ante supervision of manufacturers and preventing mis-selling.
- for industry: improved reputation due to higher trust by consumers as a result of mis-selling.

Costs:
- for manufacturers: implementation costs (medium/high) depending on requirements already in place at national level and the respective internal processes already implemented by the manufacturers.
- – NCAs: implementation costs to transpose the Guidelines into national legal framework (medium/high).

Policy issue 3: Definition of consumer

As option 4 was immediately discarded, the following options were examined:

Option 1: to define and limit consumer (and therefore the persons to be considered as the target market) to natural persons acting outside their trade, profession or business; i.e. SMEs would be excluded

Benefits:
- For manufacturers: narrower scope implies lower implementation costs for manufacturers designing products specifically for SMEs.
- For NCAs: narrower scope enables focus on supervision of selected products.

Costs:
- For SMEs: risk of mis-selling due to bad product design as SMEs not captured under the Guidelines.

Option 2: to define and limit consumer to natural persons acting their trade, profession or business and also capture small and medium enterprises; i.e. SMEs would be included

Benefits:
- For SMEs: lower risk of mis-selling due to bad product design as SMEs captured under the Guidelines

Costs:
- For manufacturers: wider scope implies higher implementation costs.
- NCAs: wider scope of supervision activities.

Option 3: to define consumer as natural persons acting outside their trade, profession or business but to grant the possibility to competent authorities to extend the definition and therefore, the persons that could be considered within the target market, without further specifying what type of firms/persons could be included within the definition; i.e. NCAs would have the freedom to include SMEs

Benefits:
- For NCAs: flexibility in defining the scope.
  Furthermore, the costs and befits for other stakeholders (e.g. manufacturers and SMEs) will depend on the decision taken by the NCA.

Costs:
- For EIOPA: risk of divergence in supervisory practice.
- for manufacturers: implementation costs.

Policy issue 4: Need for including scenario analysis

Various options were examined:

Option 1: Not to require any product monitoring or scenario analysis

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

Costs:
- For undertakings: there is a risk that the product will not at all times fulfil the identified need of the target market. This will harm the trust consumers have in the undertaking.

- For consumers: out of all Options compared, the highest risk of detriment as the products' design may not be entirely suitable. At a certain moment in time, the product can be the right choice yet the consumer doesn't know what will happen when the circumstances change.

Option 2: to only require quantitative scenario analysis for life insurance
Benefits:
- For undertakings: the most important aspect of the product is being addressed: the amount of capital that will be built within the product as well as the impact of costs on the total amount.

Costs:
- For undertakings and consumers: there is still a risk that the product will not at all times fulfil the identified need of the target market. For instance, information in the insurance policy that is unclear can lead to detriment as well.
- For consumers: risk of potential detriment in the case of non-life products.

Option 3: to require both quantitative and qualitative scenario analysis for life insurance

Benefits:
- For undertakings and consumers: 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 the consumers.

Costs:
- For consumers: risk of potential detriment in the case of non-life products.
- For undertakings: higher implementation costs than under Option 2 and 3.

Option 4: to require both quantitative and qualitative scenario analysis for both life and non-life insurance

Benefits:
- For undertakings and consumers: 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/ rebuild of trust in undertakings and their products will benefit both undertakings and the consumers.

Costs:
- In general, more requirements lead to higher costs.

Policy issue 5: Frequency of review process

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

Option 1: use the same frequency as used in the Solvency II requirements for reviewing governance processes (at least annually);

Benefits:
- For undertakings: Providing the same frequency of Solvency II could allow for an efficient running of the internal review processes required from undertakings,

especially whether the manufacturers would decide to manage the POG requirements as part of those processes requested by Solvency II requirements.
- For consumers: To extend the same frequency provided by Solvency II for the review process of the system of governance also to PG periodical review should ensure more consistency between the two processes and the amendments eventually decided.

Costs:
- For undertakings: Providing as a minimum at least an annual review of POG arrangements could be too costly for small manufacturers (especially for distributors that design the product, i.d. "manufacturer de facto") that do not introduce new products in the market nor change their product oversight process annually.

Option 2: do not specify the frequency.

Benefits:
- For undertakings: The manufacturer could adapt the frequency of the review process to the dimension of its activity and, in general, to its commercial strategy, avoiding unnecessary review.
- For consumers: If a specific frequency is not required, the manufacturer could decide to run POG review process even more often, in order to ensure that the arrangements provided are appropriate for the products distributed, with specific regard to the new ones introduced during the year.

Costs:
- For undertaking and in general: To run POG review processes with a different frequency of Solvency II review process could lead to an inconsistency between POG arrangements and the system of governance. Consequently, the manufacturer could be bound to modify again the POG arrangements with extra costs.

Policy issue 6: Responsibility of the AMSB on the establishment of POG and involvement of control functions

Regarding the particular role of the internal control functions, three options were examined:

Option 1: specify that a certain function (specifically compliance and risk management function) should be involved in the product oversight and how this function is involved including its role and tasks;

Benefits:
- For manufacturers: More concrete requirements on POG.

Costs:
- For manufacturers: confusion between governance system and product oversight and governance requirements. Lack of flexibility.
- For consumers: consumer interests are not a priority of the governance arrangements of undertakings. Therefore, this would have undermined consumer protection.

- For NCAs: problem in supervising governance and POG within a same framework (especially for twin peaks).

Option 2: specify that certain function (specifically compliance and risk management function) should be involved in the product oversight without specifying their role and tasks

Benefits:
- For manufacturers: More concrete requirements on POG.

Costs:
- For manufacturers: Confusion between governance and POG requirements, without further specifying how to implement this in practice.
- For EIOPA/NCAs: This solution would weaken POG requirements, because none of the guidelines could be read in an isolated manner. They should be integrated into the governance framework.

Option 3: not to provide any rule regarding the role of the internal control functions

Benefits:
- For manufacturers: Possibility to integrate their POG arrangement in any existing system, whatever the function is.
- For EIOPA: clear differentiation between POG and governance requirements.
- For Consumers: consumers' interests are a priority of POG arrangements.
- For NCAs: No confusion between governance and POG arrangements.

Costs:
- For manufacturers: Create a new (non-mandatory) function dedicated to POG.

Policy issue 7: Proportionality principle versus differentiation between insurance classes of business

Summary of Options considered:

Option 1: elaborate the POG GL further and differentiate between insurance business classes within the POG GL

Benefits:
- For consumers: 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 Guidelines.

Option 2: not to differentiate between insurance business classes within the POG GL and only mention the applicability of the principle of proportionality in general

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

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

Option 3: do not differentiate between insurance business classes within the POG GL, mention the applicability of the principle of proportionality and give supervisors and insurance undertakings some guidance on details of applicability of the principle of proportionality for product and governance processes.

Benefits:
- For consumers: 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 8: Need for a specific Guideline on outsourcing of product design

The following options were considered:

Option 1: specific Guideline when product design is being outsourced; meaning that the AMSB of the manufacturer stays ultimately responsible regardless of the outsourcing

Benefits:

- for consumers: Consumers' protection is ultimately assured regardless of the governmental structure and the internal decisions taken by the manufacturer how to organise the designing of its products.

- for manufacturers: 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. The manufacturer keeps the ultimate responsibility and can ensure that the products offered do 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 the contract.

- for supervisory authorities: When supervising the manufacturer the supervisory authority concerned has one point of contact, the AMSB of the insurance undertaking and not unknown third parties like the service provider. It is assumed that the supervisor is engaging in several dialogs 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 do require the ultimate responsibility of the AMSB for any outsourced important function. To issue a similar guideline with the same underlying principle assures a better and consistent approach of consumer protection throughout different areas.

Costs:

- for consumers: Consumer may face higher costs for insurance products. The risks is 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 this product, meaning the consumer.

- for manufacturers: As described above the manufacturer may face higher costs when outsourcing its product design. Second, 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 2: no specific Guideline; meaning that the responsibility for applying the requirements is not specifically described in case of outsourcing

Benefits:
- No particular benefits in comparison to Option 1 were identified as the manufacturer remains responsible for any outsourced activities..

Costs:
- for consumers: The consumer could face insufficient consumer 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 consumer has no knowledge of how the product has been designed. Therefore, insufficient information is given which does not allow consumers to make a clear choice.

- for supervisory authorities: In the case of outsourcing the supervisory authority would not have any possibility to take supervisory actions if needed and deemed necessary. The supervisory power would be limited and the objective of enhanced consumer protection cannot be followed.

- for EIOPA: The system of governance under Solvency II includes requirements on outsourcing. In case of a different approach by the POG guidelines no consistent approach is given. This could result in an un-level playing field of topics from the perspective of risk-based supervision.

6. Comparing the options

Policy issue 1: Choice of appropriate legal instrument

While IMD 2 is also expected to contain relevant provisions related to product oversight and governance and thus has the potential of providing EIOPA with the necessary legal basis to capture both activities of manufacturing and distributing, the legislative proposal is currently under negotiation. Given the uncertain timing and outcome, and the potential for regulatory arbitrage across the sectors, it was decided not to follow **option 1** and to take action. Furthermore, it was considered the convenience of using this instrument as an opportunity to form EIOPA's understanding on how these standards should be drafted, once a technical advice is requested by the European Commission. These Guidelines are issued with the view that they could possibly be converted into a basis for a technical advice if the requirements are finally included and requested in IMD2.

Option 2 (issuing opinion/best practices) was considered not appropriate, as it might create the possibility for regulatory arbitrage and might not deliver similar level protection to consumers for all the three sectors. That is because to guarantee a similar level of protection across the three sectors, the legal tools under which the

requirements are issued should have similar binding force. Likewise, there is body of evidence [that demonstrate that poor product design and insufficient product governance in the past, has derived into serious cases of detriment e.g. in CZ, ES, FR, HU, IE, IT, LT, NL, SE and UK. Due to the considerations described above, it was decided that **option 3** would be the most appropriate option to frame product oversight and governance requirements.

Policy issue 2: Choice of addressees and legal basis

Option 1 would be the preferred option as it is acknowledged that, in order to cover the entire life cycle of a product, financial institutions carrying out the activities of manufacturing and distributing should follow a set of requirements. This is the approach followed by product governance requirements for investment and banking products developed by the other European Supervisory Authorities (ESAs). Only by capturing both types of activities, it can be guaranteed that a product originally conceived for a particular target market would effectively be sold within that target market, taking into account the characteristics of distribution in the insurance sector (e.g. direct sales or intermediated sales). However, EIOPA currently does not have the necessary legal basis to address principles applicable to the activity of distribution and therefore, **option 1** was not followed: (i) Solvency II regulates the taking up of business of insurance undertakings but it does not cover insurance distribution by insurance undertakings, nor does it regulate the business of insurance intermediaries, and (ii) the current IMD text does not contain provisions on or related to product oversight and governance for insurance intermediaries, nor does it apply to insurance undertakings when carrying out insurance distribution activities

MIFID II has amended IMD and inserted a series of requirements aimed at identifying and minimising conflicts of interest in relation to the sale of insurance-based investment products. Since conflicts of interest are very relevant to product oversight and governance as, in the process of designing products, manufacturers need to ensure that they "act honestly, fairly and professionally in accordance with the best interests of their customers" and "take all reasonable steps designed to prevent conflicts of interest from adversely affecting the interests of their customers", it could be argued that these new Articles could form the legal basis to address requirements to distributors. However, it was recognised that these Articles would only empower EIOPA to issue requirements in relation to distribution of insurance based-investment products and not to capture other insurance products, which has the potential to create a distortion in the market – one of EIOPA's statutory objectives is to "prevent regulatory arbitrage and promote equal conditions of competition". In addition, this might conflict with IMD2 later if it were to include product oversight and governance provisions covering all insurance products. Therefore, **option 2** was discarded.

Consequently, **option 3** was followed as it was decided to address requirements only to manufacturers as this point and, once a clear legal basis exists, to prepare similar requirements for the distribution activity of all insurance products.

The convenience of extending the requirements for manufacturers to insurance intermediaries who are "de facto" manufacturers when they are involved in the design and manufacture of a product (in the same way as currently proposed by EBA) was also discussed. Due to the fact that, very often, insurance intermediaries take an active role in the design of insurance products - in some jurisdictions, insurance products are often designed by the intermediary and an insurance undertaking only accepts to take the risks - it was considered appropriate to request those distributors

to follow the same principles as manufacturers when acting as those, to preserve the spirit of the rules.

Policy issue 3: Definition of consumer

Option 4 proved quite difficult to apply in practice, as this might have different connotations in different Member States. Consumer though, is the term used and referred to in the Joint Committee principles on product governance, the basis and starting point of this piece of work, meaning consumers' protection.

Due to the fact that consumer detriment is not limited to natural persons acting outside their main business and undertakings but can also occur between SMEs/ legal persons and undertakings, EIOPA has chosen to give NCAs the discretion to adapt the definition of consumer, including e.g. the possibility to apply these requirements to SMEs and legal persons as well. The way in which this discretion is drafted in the Guidelines provides Member States the option to extend the definition of consumer in order to capture other types of legal persons such as SMEs. It is suggested that SMEs could also be included in the definition but, leaving open the possibility to extend this even further. The option chosen was **option 3**.

Policy issue 4: Need for including scenario analysis

One can run a quantitative test in order to see whether risk and return are well balanced under different scenarios for unit linked investments. For non-life insurance, one can look for instance at the coverage of the product to see under what conditions, or in which 'scenario's, an overlap with other products occur. And 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 Guidelines capture all types of insurance products, it was decided that **option 4** is the most appropriate level of requirement.

Policy issue 5: Frequency of review process

The positive aspect of **option 1** is that it provides consistency with Solvency II which is requesting several processes at least annually for insurance companies; however; EIOPA considered too costly the imposition of an annual review to small undertakings or to those that do not often design new products. On the other hand, an annual review could be seen as not sufficiently effective for big insurance undertakings or for those that design new product lines very frequently, certainly more than once a year.

Due to these considerations, **option 2** was followed and the Guidelines do not specify the frequency of the process, leaving such decision to the manufacturer's decision. 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 that it manufacturers.

Policy issue 6: Responsibility of the AMSB on the establishment of POG and involvement of key functions

It has been noticed that product oversight arrangements can be integrated in different manners within the insurance undertaking and the role of the key function could differ between companies and/or change due to the internal organisation of the product design process and the consequent oversight and governance.

According to this, it has been highlighted that **options 1 and 2** could have a negative impact (extra costs or organizational difficulties) in case of inconsistency between the Guidelines and the already existing processes inside companies. On the contrary, **option 3** seems to have positive effects in terms of guaranteeing the possibility of an implementation on the Guideline consistent with the complexity and the scale of the business and the organization of the manufacturer. Meanwhile, the ultimate responsibility of AMSB (common to all the options) has been considered as a sufficient tool in order ensure an effective oversight and responsibility lines over product oversight and governance arrangements of the manufacturer. In addition this requirement reflects the principle of responsibility of the AMSB in the Solvency II requirements on system of governance.

Policy issue 7: Proportionality principle versus 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 2 seemed preferable. Besides, the criteria for the proportionality principle as well as for its application are being referred to in the Solvency II Directive[15].

Taking this into consideration, Option 2 was chosen. It points out that the principle of proportionality does not mean only to ensure an proportionate application of the Guidelines in order to limit burden on small size manufacturers but also to avoid too burdensome processes for insurance business classes with lower risk and / or complexity.

Policy issue 8: Need for a specific Guideline on outsourcing of product design

In the system of governance requirements under Solvency II the insurance undertaking stays 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 consumer protection.

It was concluded that in order to ensure that the product design complies with and serves the overall objective of these guidelines to enhance consumer protection - even in those cases where the manufacturer has chosen to outsource this tasks -, a specific Guideline was needed. Hence **Option 1** is the preferred option. This option does not prevent the manufacturer from organising his internal processes to best fit his business and to avoid consumers' detriment at the same time.

[15] 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."

7. Monitoring and evaluation

EIOPA may consider monitoring and evaluating whether the Guidelines are effective and efficient in fulfilling the objectives specified in Section 3 of the Impact Assessment.

To this end, EIOPA may, for example, carry out a Peer Review among the EIOPA members on the Guidelines and their implementation into national supervisory practice.