

Near final: The Insurance Distribution Directive

On 22 July 2015, the European Council published a press release confirming its approval through its Permanent Representatives Committee of the final compromise text for the revision of the existing Insurance Mediation Directive ("**IMD**"), now renamed the 'Insurance Distribution Directive' ("**IDD**").

The IDD has now been submitted to the European Parliament for a vote at first reading, before final consideration and adoption by the European Council. Member States will then have two years to transpose the IDD into national laws and regulations, with IDD related amendments to the FCA Handbook and PRA Rulebook expected in late 2017.

This briefing provides a background on the IDD and outlines the main changes for UK insurance distributors - insurance intermediaries, ancillary insurance intermediaries and insurance undertakings - and for reinsurance distributors – all new defined terms under the IDD.

The analysis in this briefing is based on [the IDD final compromise text of 16 July 2015](#).

Harmonisation

The IDD, like IMD, will have the features of a 'minimum harmonisation'

legal instrument. It will, therefore, set a minimum threshold for Member States to meet, however each Member State may elect to implement further measures, if they deem this necessary for the purposes of consumer protection. Once again, this leaves scope for 'gold-plating' and risks uneven implementation – despite these issues being the main reason for revising the IMD.

Implementation

The current draft of the IDD envisages that the minimum directive

Background

- The IDD is the recast of the IMD 2002/92/EC and forms part of the European Commission's wider 'Consumer Retail Package' – a legislative package which includes a proposed Regulation on key information documents for packaged retail and insurance based investment products ("**PRIIPS**") – further information can be found in the [Clifford Chance PRIIPS briefing](#).
- The IMD, which was implemented in 2005, regulates the point of sale of insurance products and was intended to create a single market for the sale of insurance products.
- However, a review of the IMD carried out by the European Commission during 2005-2008 found inconsistent application of IMD at the national level, with some Member States gold-plating measures and others implementing the bare minimum necessary for compliance.
- The IDD is an attempt to rectify these identified failings and essentially seeks to improve regulation in the retail insurance market and improve consistency between Member States by strengthening policyholder protections and ensuring a level playing field between all participants involved in the selling of insurance products.

standards be reinforced by Level 2 delegated acts further specifying governance and information requirements. In the former case, these will be measures on the 'product approval process' that insurance undertakings and intermediaries are required to have in

place¹. In the latter case, it will be measures establishing the criteria for determining the types of conflicts on the selling side that may damage the interests of customers or potential customers² and the criteria for assessing inducements paid by an insurance undertaking or intermediary³.

Further scope for harmonisation is given by Article 21 (3) of the final compromise text, which allows the European Insurance and Occupational Pensions Authority ("EIOPA") to develop Level 3 guidelines for assessing and supervising cross-selling practices which will indicate situations where cross-selling will not comply with the duty to act 'honestly, fairly and professionally in accordance with the best interests of its customers'⁴. Clearly, this gives EIOPA a potentially wide reaching ability to determine the ability of distributors to cross-sell products.

The use of Level 2 and 3 measures for a 'minimum harmonisation' instrument is unusual and it remains to be seen how this will operate in practice alongside Member State implementation.

Firms are advised to monitor the implementation of the IDD by those Member States in which they operate to ensure compliance with local insurance distribution requirements. It is clear that these will vary across jurisdictions as a result of the ability for Member States to implement

Summary of key changes

Scope of IDD

- Scope extended to include direct sales by (re)insurance undertakings and certain activities of aggregator/price comparison websites.
- "Connected Contracts Exemption" only applicable to 'ancillary insurance intermediary carrying out insurance distribution activities' where certain (and different from previous) conditions are met.

Enhanced professional requirements & certification

- New requirement of 'continuing professional training and development' and at least 15 hours of professional training or development per year, taking into account the nature of the products sold, the type of distributor, the role performed and the activity carried out by the (re)insurance distributor.
- Successful completion of training and development to be proven by obtaining a certificate.

Conduct of business

- Requirement that an insurance distributor 'always acts honestly, fairly and professionally in accordance with best interests of the customer'.
- Marketing communications must be 'fair, clear and not misleading'.

Disclosure

- Specific disclosures must be made before the conclusion of an insurance contract, including possible conflicts of interests, type of remuneration received and fees payable (including amounts) by the customer.
- Possibility of Member States imposing stricter requirements on remuneration and information disclosure.
- For 'non-life insurance products' a standardised 'insurance product information document' will need to be provided to a customer before the conclusion of an insurance contract.

Governance & information requirements

- Requirement for a 'product approval process' proportionate and appropriate to the nature of the insurance product.
- Commission empowered to adopt delegated acts to further specify product oversight and information requirements.

Cross-selling

- When a product is offered with another service or as part of a package, the distributor must inform the customer whether it is possible to buy the different components separately and, if so, they must provide an adequate description of the different components as well as separate evidence of costs and charges.
- EIOPA may develop guidelines for the assessment and supervision of cross-selling practices if necessary.

Insurance-based investment products

- Additional requirements on conflict of interests, information disclosure prior to the conclusion of a contract, suitability and appropriateness of a product given a customer's 'risk tolerance and ability to bear losses'.

Cross border activity

- New provisions regarding the freedom to provide services and the freedom of establishment.

¹ Article 21a (2) of the IDD final compromise text of 16 July 2015

² Ibid. Article 23 (3)

³ Ibid. Article 24(14) and (15)

⁴ Ibid. Article 15(1)

provisions beyond the terms of the IDD itself.

Scope

The IMD applies to 'insurance intermediaries' whilst the IDD applies to 'insurance distributors'⁵. Based on the new definition of 'insurance distribution' and 'insurance distributor', this appears to encompass a larger number of firms than before.

Direct sales

The IMD applies to insurance intermediaries only. However, the IDD now provides that insurance undertakings which sell insurance products directly will be brought into scope.

This is a significant departure from the IMD (although many direct insurers hold IMD permissions) and is expected to increase coverage substantially as direct selling European insurers are impacted. Such insurers are advised to look at their product lines now to determine whether existing policies and processes need updating to meet the new requirements.

Websites

The IDD (unlike the IMD) expressly applies to certain activities conducted through aggregator/price comparison websites. Undertakings running such websites will need to register with a competent authority in their home Member States. In the UK, aggregator websites already need to be authorised, but this is not the case in other jurisdictions.

⁵ The UK requires insurers to obtain authorisation for their insurance mediation activities.

Key new terms

- **'insurance distribution'** means the activities of advising on, proposing or carrying out other work preparatory to the conclusion of contracts of insurance, concluding such contracts, or assisting in the administration and performance of such contracts, in particular in the event of a claim .
- The provision of information concerning one or more insurance contracts in accordance with criteria selected by customers through a website or other media and the compilation of an insurance product ranking list, including price and product comparison, or a discount on the price of an insurance contract, when the customer is able to directly or indirectly conclude an insurance contract using a website or other media will be considered to be insurance distribution.
- None of the following activities will be considered to be insurance distribution for the purposes of the IDD:
 - the provision of information on an incidental basis to a customer in the context of another professional activity , if the provider does not take any additional steps to assist in concluding or performing an insurance contract;
 - the management of claims of an insurance undertaking on a professional basis, and loss adjusting and expert appraisal of claims;
 - the mere provision of data and information on potential policyholders to insurance intermediaries or insurance undertakings if the provider does not take any additional steps to assist in the conclusion of an insurance contract;
 - the mere provision of information about insurance products or an insurance intermediary or insurance undertaking to potential policyholders if the provider does not take any additional steps to assist in the conclusion of an insurance contract.

The Connected Contracts Exemption

Any person that does business on the basis of the Connected Contracts Exemption ("CCE") does not need to be authorised under the IMD regime implemented in the UK.

The current CCE is set out in Article 1(2) of the IMD and provides an exemption from the application of the IMD for insurance intermediaries (whose principal professional activity is other than insurance mediation) in circumstances where the insurance is complementary to a product or service supplied by any supplier and where:

- such insurance covers the risk of breakdown, loss of or damage to goods or services supplied by that provider, and
- the amount of the annual premium does not exceed
- €500; and
- the total duration of the insurance contract, including any renewals, does not exceed five years.

Under Article 1(2a) of the compromise text, a CCE will still be available but only to 'ancillary insurance intermediaries carrying out insurance distribution activities' and where:

- the insurance is complementary to the good or service supplied

by any provider, where such insurance covers:

- the risk of breakdown, loss of or damage to the goods or the non-use of the service supplied by that provider or;
- damage to or loss of baggage and other risks linked to the travel booked with that provider;
- the amount of the premium paid for the insurance product does not exceed
- €600 pro-rata annually.
- where the insurance is complementary to a service supplied, and the duration of that service is equal to or less than three months, the amount of the premium paid per person does not exceed €200.

The increase of the maximum annual premium (for insurance covering services supplied for longer than a three month period) from €500 to €600 could impact on the scope of distribution business and the type of insurance cover offered. The removal of the five year limitation period applicable is a welcome change as it should alleviate the uncertainty created where an exclusion permits a policy renewal beyond 5 years.

The UK has 'gold-plated' the current CCE so that the exemption is more restrictive than the IMD. This may or may not continue following implementation of IDD so firms will need to monitor implementation closely. However, where the directive does apply to ancillary intermediaries, firms will need to confirm that all such entities are properly authorised and that their contractual arrangements reflect the legislative changes.

Key new terms continued...

- **'insurance distributor'** means any insurance intermediary, ancillary insurance intermediary or insurance undertaking;
- **'insurance intermediary'** means any natural or legal person, other than an insurance or reinsurance undertaking or their employees and other than an ancillary insurance intermediary, who, for remuneration, takes up or pursues the activity of insurance distribution;
- **'ancillary insurance intermediary'** means any natural or legal person, other than a credit institution or an investment firm as defined in Article 4(1) of Regulation (EU) No 575/2013 [CRD IV], who, for remuneration, takes up or pursues the activity of insurance distribution on an ancillary basis, provided that all the following conditions are met:
 - the principal professional activity of that natural or legal person is other than insurance distribution;
 - the natural or legal person only distributes certain insurance products that are complementary to a good or service;
 - the insurance products concerned do not cover life assurance or liability risks, unless that cover complements the product or service which the intermediary provides as his principal professional activity;

Disclosure

Remuneration

The most significant change from previous versions of the directive is that the compromise text foresees only a pre-contractual disclosure of the nature and the basis of the remuneration (whether paid on the basis of a fee, commission, or other type of arrangement)⁶. The text also includes the criteria under which Member States may allow insurance distributors to continue to earn revenue through commissions or third party payments.

In the UK, intermediaries are already required to disclose remuneration under ICOBS rules in respect of commercial customers if requested,

however consideration will have to be given to the new IDD requirement to always provide consumers with the nature and basis of remuneration, and the manner in which these disclosures will be made.

Remuneration disclosure is definitely an area where we can expect some developments, especially as the FCA has already flagged in their thematic review '[Commercial insurance intermediaries – Conflicts of interest and intermediary remuneration Information](#)' that, in some cases, remuneration disclosure provided to customers by insurance intermediaries is very generic and unlikely to meet their information needs or enhance their understanding of the services and product provided.

⁶ Ibid. Article 17

Recent judgements⁷ concerning the failure by banks to reveal commission payments in relation to Payment Protection Insurance ("PPI") also serve as an indication that the FCA will look at remuneration disclosure rules with greater scrutiny – particularly where commission levels are higher than a customer could reasonably expect. We are aware of other European regulators who have recently sought to impose rules limiting remuneration to reasonable or justifiable levels for certain products so this will be an area to review as we move to local implementation of the IDD.

Information

Prior to the conclusion of an insurance contract, the insurance distributor must specify, on the basis of information obtained from the customer, the demands and the needs of that customer and must provide the customer with objective information about the insurance product in a comprehensible form ('a product information document') to allow that customer to make an informed decision.⁸

Stricter provisions

The full impact of commission disclosure and the information requirements as set out in the IDD will only be clear following implementation into national legislation as it is open to Member States to go further than the IDD. For example, Article 19 (2a) of the IDD proposes that Member States may limit or prohibit the acceptance or

receipt of fees, commissions or other monetary or non-monetary benefits paid or provided to insurance distributors by any third party, or a person acting on behalf of a third party, in relation to the distribution of insurance products. It will be interesting to see whether the UK, on implementation of IDD, will revise the position it adopted on commission prohibition and exemptions on this prohibition implemented following the Retail Distribution Review.

Separately, the IDD permits information exemptions⁹ in relation to distribution activities concerning the insurance of large risks and distribution by reinsurance intermediaries or reinsurance undertakings. For such activities and undertakings, Member States may maintain or adopt stricter provisions regarding the information requirements provided that such provisions comply with Union law.

Professional requirements

The professional knowledge of those involved in activities preparatory to, during and after the sales of insurance policies needs to match the level of complexity of these activities.

The IDD currently foresees a minimum of 15 hours of professional training or development per year, taking into account the nature of the products sold, the type of distributor, the role they perform and the activity carried out within the insurance or reinsurance distributor. Successful completion will be proved by a certificate. The training requirements have the potential to be a demanding

change and their difficulty will be dependent on how they are implemented locally.

(Re)insurance intermediaries will also be required to hold at least €1.25 million per claim or in aggregate €1.85 million unless such insurance or comparable guarantee is already provided by insurance or other undertaking on whose behalf the intermediary is acting.¹⁰ This is a rise as compared to IMD requirements, which are currently €1 million or €1.5 million. Ancillary insurance intermediaries will also be required to hold professional indemnity insurance.

Conduct of business

The IDD introduces a new conduct requirement to 'always act honestly, fairly and professionally in accordance with the best interests of the customer'.¹¹ It is not yet clear what this will mean in practice, nor how the obligation will interact with requirements relating to the provision of advice.

Firms will need to review existing customer-facing practices and arrangements to ensure that they are in a comprehensible form and that they sufficiently demonstrate a consideration of both the demands and needs of the customer before the proposal of a product.

The new conduct requirements shouldn't be challenging to UK authorised undertakings who should already be complying with Article 15 of the compromise text proposals by following FCA high-level principles for businesses (PRIN) – and the PRA

⁷ Plevin v Paragon Personal Finance Ltd [2014] UKSC 61; Harrison v Black Horse Ltd [2012] Lloyd's Rep IR 521

⁸ Ibid. Article 18(4)

⁹ Ibid. Article 19

¹⁰ Ibid. Article 8(3)

¹¹ Ibid. Article 15

equivalent 'Fundamental Rules'. The cross-over between the current UK regulatory regime and the IDD proposals is marked, for example, at Principle 1, which requires a firm 'to act with integrity', Principle 6, which requires firms to 'treat customers fairly' and Principle 8, which provides that 'a firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client'.

Governance

The IDD requires firms to operate and review a 'product approval process'¹² for each insurance product they offer and to review any significant adaptations of existing products before they are marketed or distributed to customers. This process requires firms to identify target markets and ensure that risks to the target market are assessed and managed.

The FCA signalled a similar 'product approval process' to the one proposed for the IDD in a recent thematic review: [TR15/2: Structured Products: Thematic Review of Product Development and Governance](#). Firms, therefore, should already have an approval process or something similar to the one proposed in the IDD to meet FCA expectations.

Firms are advised to review existing approval processes ahead of IDD implementation. Additionally, strategies for identifying target markets and any distribution strategies should also be reviewed to ensure that, on an on-going basis, the

demands and needs of the target market are being monitored and assessed against the product offering and to determine whether the distribution strategy remains effective.

Cross-selling/Bundling

Article 21 of the IDD compromise text sets out specific information requirements in relation to 'cross-selling' which will have an impact on 'bundling' of insurance products with other products or services.

The IDD requires the insurance distributor to tell the customer of the possibility of buying the different components separately. If they can be brought separately, an adequate description of the different components of the agreement or package as well as a separate evidence of the costs and charges of each component must be provided.

The proposed requirements could hamper the availability of 'bundling' products which can result in greater choice for consumers, and cost-effective access to insurance. In any event, the impact on cross-selling will be clearer once EIOPA develop guidelines for the assessment and supervision of these practices.

¹² Ibid. Article 21a

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88249-3-10760