

MiFID II & IDD: The impact on insurance based investment ("IBI") products

On 2 February 2016, the [final text of the Insurance Distribution Directive \("IDD"\)](#) was published in the Official Journal of the EU ("OJ"). The IDD entered into force on 22 February 2016 and Member States will need to comply with the new requirements by 23 February 2018.

The IDD introduces specific requirements for distributors of IBI products. These requirements, which are essentially changes driven by the Markets in Financial Instruments Directive II ("MiFID II"), oblige insurance distributors to act in the best interests of clients purchasing IBI products.

This briefing takes a closer look at Chapter VI of the IDD, which sets out the additional requirements, relevant where 'insurance distribution' is carried out in relation to the sale of IBI products by an 'insurance intermediary' or an 'insurance undertaking', as defined by the IDD.

Firms selling IBI products in the UK are already subject to many of the IDD requirements, through the FCA's COBS regime and due to the UK's 'gold plating' of the Insurance Mediation Directive ("IMD") and the Retail Distribution Review, but they will still need to consider the extent to which changes are needed to ensure regulatory compliance.

Key points

- To deliver consistent investor protection and to align with MiFID II requirements, IBI products under the IDD will be subject to specific standards aimed at addressing the investment element embedded in those products, including
 - provision of appropriate information,
 - requirements for advice to be suitable and appropriate.
- IBI products will also be subject to the conduct of business standards defined for all insurance products subject to the IDD.
- To ensure that any fee, commission (or any non-monetary benefit) in connection with the distribution of an IBI product paid to or paid by any party, except the customer or a person on behalf of the customer, does not have a detrimental impact on the service quality provided, the insurance distributor is required to put in place appropriate and proportionate arrangements in order to avoid such detrimental impact. To that end, under the IDD, an insurance distributor will be required to:
 - develop, adopt and regularly review policies and procedures relating to conflicts of interest with the aim of avoiding any detrimental impact on the quality of the relevant service to the customer; and
 - ensure that a customer is adequately informed about fees, commissions or benefits.
- The FCA has indicated that it expects firms currently selling IBI products to be already captured under its COBS regime. However, the IDD requirements should still be considered to determine whether there are any resultant changes.

This briefing also identifies other EU developments relevant to IBI products, including [Regulation \(EU\) No 1286/2014](#) on key information documents for packaged retail and insurance-based investment products ("the PRIIPs Regulation") and the European Insurance and Occupational Pensions Authority's ("EIOPA's") recent [consultation on preparatory Guidelines on product governance and oversight](#).

Current regime

In DP 15/3 [Developing our approach to implementing MIFID II Conduct of business and organisation requirements \(March 2015\)](#) the FCA flagged that they already apply most of their conduct of business (COBS) rules to IBI products in the UK. This is because these products are generally viewed as being in the same relevant market, and often substitutable with, MiFID II investment products.

The FCA also confirm that manufacturers and distributors of IBI products are therefore currently subject, to a large extent, to the same COBS rules that apply to the conduct of MiFID II business. These include rules on suitability, client reporting, and third party inducements.

Although the FCA have not yet considered specific changes arising out of IDD, they do flag in DP 15/3 a clear intention to apply a consistent regulatory regime to help maintain a consistent level of protection for clients and mitigate against regulatory arbitrage and any resultant distortions in competition between substitutable products.

In the next year, the FCA will need to make a policy decision on their domestic approach to IBI products, both in terms of whether they maintain consistency generally, and specific changes to COBS rules and

Background

- The Markets in Financial Instruments Directive I ("**MiFID I**") came into force on 1 November 2007. It had to improve the competitiveness of EU financial markets by creating a single market for investment services and activities, and ensuring a high degree of harmonised protection for investors in financial instruments, such as shares, bonds, derivatives and various structured products.
- The financial crisis of 2008 exposed some of the weakness in MiFID I and these failings were retrospectively identified by a European Commission initiated consultation in 2010. This also led to the Commission's publication of a formal legislative proposal to amend MiFID I (including a proposal for a new Directive ("**MiFID II**") and a Regulation (MiFIR) on 20 October 2011.
- MiFID II entered into force on 2 July 2014. On its entry into force, it amended the Insurance Mediation Directive ("**IMD**") in order to extend MiFID II style consumer protection to IBI products which are not 'financial instruments' (as defined in Article 4 (15) MIFID II) and which therefore fall outside the scope of the MiFID II legislation.
- IMD as amended by MiFID II but before its amendment and eventual repeal by the IDD is sometimes referred to IMD 1.5.
- The IDD is intended to complement the rules on the sale of investment products in MiFID II, but enhances those made in IMD 1.5 because it also introduces requirements similar to those introduced by the PRIIPS Regulation (EU) No 1286/2014. For more information on PRIIPS, [please see our previous briefing](#).

organisational requirements, given the larger scope of the IDD.

Scope

By introducing new defined terms such as 'insurance distribution' and 'insurance distributor', the IDD significantly extends the scope of application as compared to that of the [Insurance Mediation Directive 2002/92/EC](#)¹.

For further analysis on the scope of IDD and the impact on non-IBI

products, please refer to our briefing: [Near final: The Insurance Distribution Directive, dated 3 September 2015](#).

Consumer type

Some of the IDD provisions place obligations on insurance distributors only whilst others make reference to 'consumers' or 'customer'. There is no general definition of 'consumer' or 'customer' in the final text of IDD but it is clear from the use of the terms that they cover retail customers.

The term 'professional client' is used in the IDD but only in Recital 51 and Article 22(1). It is defined, by reference to Article 4(1)(10) of the MIFID II Directive, to mean a client who 'possesses the experience, knowledge and expertise to make

¹ Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation

their own investment decisions and properly assess the risks they incur'. The definition expressly includes pension funds and management companies of such funds.

Recital 51 of the IDD confirms that, in some cases, where the customer is a professional client there is less need for the provision of information to enable a customer to make an informed choice. This expectation is confirmed in Article 22(1) IDD which allows Member States to disapply the IDD information requirements where a customer is a professional client but only in respect of IBI products.

In addition to the IDD drafting points above, the FCA is afforded discretion to apply higher standards in some areas than under the IDD itself, so the ultimate impact on a business is subject to the FCA's approach to transposition of the IDD requirements.

What is an IBI product?

Under the IDD, an IBI product is one which offers a maturity or surrender value and which has an 'investment element' i.e. where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations. This part of definition is the same as that used for IBI products in the PRIIPS Regulation, which requires a pre-contractual disclosure document (a key information document or "KID") for certain products, including IBI products.

However, the IDD definition expressly excludes:

- (a) non-life insurance products as listed in Annex I to the Solvency II Directive 2009/138/EC (Classes of Non-life Insurance);

IDD requirements applicable to all insurance products

Duty to act in customers' best interests

Article 17 IDD – a new 'general principle' on insurance distributors to:

- Always act honestly, fairly and professionally in accordance with the best interests of their customers.

Provision of general information

Article 18 IDD – in good time **before** the conclusion of an insurance contract, an insurance intermediary/ undertaking must disclose:

- Its identity and address, and the fact that it is an insurance intermediary or insurance undertaking, as appropriate.
- Whether it provides advice about the insurance products sold.
- The procedures enabling customers and other interested parties to register complaints as referred to in Article 14 IDD.
- The out-of-court complaint and redress procedures (see Article 15 IDD).

Conflicts of interest and transparency

Article 19 IDD – an insurance intermediary must provide customers in good time **before** the conclusion of an insurance contract with various types of information, including:

- Whether it has a direct or indirect holding representing 10% or more of the voting rights or capital in a given insurance undertaking.
- Whether a given insurance undertaking or parent undertaking of a given insurance undertaking has a direct or indirect holding representing 10% or more of the voting rights or capital in the insurance intermediary.
- In relation to the contracts proposed or advised on, whether advice is given on the basis of a 'fair and personal analysis' or where there is a contractual obligation regarding exclusivity with one or more insurance undertakings (and, if so, the names of the insurance undertakings must be provided); or if neither of the earlier conditions apply, then the insurance intermediary must provide the names of the insurance undertakings with which it may and does conduct business).
- The nature of the remuneration (i.e. a fee, commission or some other economic benefit in kind) received in relation to the insurance contract (but not amount).

Advised and non-advised sales standards

Article 20 IDD – this sets out various requirements in relation to sales, including:

- 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 provide objective information in a comprehensible form to allow that customer to make an informed decision on the product.
- For non-life insurance products, the product information must be provided in the form of an 'insurance product information' document drawn up by the insurer – the details of which are specified in Article 20(7) and (8) IDD.

- (b) life insurance contracts where the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or disability;
- (c) pension products which, under national law, are recognised as having the primary purpose of providing the investor with an income in retirement, and which entitle the investor to certain benefits;
- (d) officially recognised occupational pension schemes falling under the scope of the Occupational Pension Funds Directive 2003/41/EC or the Solvency II Directive 2009/138/EC; and
- (e) individual pension products for which a financial contribution from the employer is required by national law and where the employer or the employee has no choice as to the pension product or provider.

These exclusions result in a small selection of products, for example, unit-linked policies, with-profits policies and investment-linked income annuities (which are not considered pension products) that must comply with the IDD additional consumer protection requirements and, as confirmed by Recital 42 of the IDD, provide information in the form of a KID too.

Additional IBI requirements

Scope

Article 26 IDD makes clear that Chapter VI requirements which apply only to IBI are *additional* to the requirements set out in Article 17, 18,

19 and 20 (detailed in the box opposite) which apply to all products within scope of the IDD.

Broadly, the additional IDD requirements on IBI products are as follows:

- Article 27 – Prevention of conflicts of interest
- Article 28 – Conflicts of interest
- Article 29 – Information to customers
- Article 30 – Assessment of suitability and appropriateness and reporting to customers

Conflicts of interest and prevention of conflicts

Under Article 27 IDD, an insurance intermediary or an undertaking carrying on distribution of IBI products is expected to maintain and operate 'effective organisational and administrative arrangements' with a view to taking 'all reasonable steps' to prevent a conflict of interests, which as determined under Article 28 IDD, could adversely affect the interests of customers.

The wording in Article 27 is purposefully vague because the IDD, like the IMD, is a 'minimum harmonisation' instrument. This means that the details as to what 'effective organisational and administrative arrangements' are necessary will be determined by the national competent authorities. In the UK, this will be the FCA and we would expect the FCA to align IDD conflict requirements with those in its COBS and SYSC regime, both of which

effectively stem from Principle 8 of the FCA's Principles for Business².

The FCA's course of action is subject to Article 28(3) IDD. This confers a power on the European Commission to adopt delegated acts, which will be directly effective (therefore no need for the FCA to implement via Handbook provisions) and will:

- Define the steps that insurance intermediaries and insurance undertakings might reasonably be expected to take to identify, prevent, manage and disclose conflicts of interest when carrying out insurance distribution activities.
- Establish appropriate criteria for determining the types of conflicts of interest whose existence may damage the interests of customers or potential customers.

It seems counter-intuitive for a minimum harmonisation directive to specify more detail through delegated acts but it will be interesting to see how detailed the provisions turn out to be.

In any case, the FCA flagged in a recent thematic review: [TR14/9 Commercial insurance intermediaries – conflicts of interest and intermediary remuneration – May 2014](#), that conflicts of interest and their management was an area of concern and that there would be more proactive engagement with the intermediary industry to understand the application of current FCA rules. The FCA has identified this as an area which is ripe for change and so

² Principle 8 - A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.

insurers and insurance intermediaries should take steps now to ensure that their own conflicts identification and management are not lacking.

Information to customers

In addition to Article 18 and 19 IDD information requirements, insurance intermediaries and undertakings must comply with Article 29 IDD requirements in relation to IBI products including the following, as a minimum, in good time before a contract is concluded:

- Where advice is provided, whether a periodic assessment of the suitability of the IBI products recommended to that customer will also be provided.
- Appropriate guidance on, and warnings of, the risks associated with the IBI products or in respect of particular investment strategies proposed.
- Cost information relating to the distribution of the IBI product, including the cost of advice, where relevant, the cost of the IBI product recommended or marketed to the customer, and how the customer may pay for it.

The IDD also requires that information about costs and charges that are not caused by the occurrence of underlying market risk must be in aggregate form to allow the customer to understand the overall cost, as well as the cumulative effect on the investment return. If the customer requests, an itemised breakdown of the costs and charges must be provided.

The IDD, also under Article 29(3), allows Member States to impose stricter IBI product information requirements. Given that consumer

protection is part of the FCA's strategic objective and its renewed focus on long term investments, which were flagged in its [2014/2015 business plan](#), we would expect the FCA to use this directive discretion to implement higher requirements, but the impact of these may be limited given that the UK has already gold plated the IMD and has banned commissions on investment products altogether under the Retail Distribution Review ("RDR"). However such raising of standards is subject to Article 29(4) IDD which allows the Commission to adopt delegated acts to specify the criteria for assessing:

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

Assessment of suitability and appropriateness and reporting to customers

Article 30 IDD requires an insurance intermediary or insurance undertaking providing advice on an IBI product to conduct an assessment to ascertain the suitability and appropriateness of a product. This requirement is replicated from that imposed by on investment firms by Article 25 of the MIFID II Directive.

Suitability assessment

This assessment, required under Article 30(1) IDD (and which is already required for firms through COBS 9), will need the following

information to be acquired about the customer:

- Knowledge and experience in the investment field relevant to the specific type of product or service.
- Financial situation, including the ability to bear losses.
- Investment objectives, including their risk tolerance.

To ensure the above obligations are met, the information could be obtained by asking customers to fill out a questionnaire and to submit documents to evidence their financial position. A credit check and score could also demonstrated some of the above requirements. In any case, the suitability assessment should be documented. Additionally, a record of any documents which set out the rights and obligations of the parties must be retained.

Suitability statement

Under Article 30(5) IDD, insurance intermediaries or insurance undertakings must, **before** concluding the IBI product contract, provide the customer with a 'suitability statement' on a 'durable medium which must specify the advice given and how it meets the customer's preferences, objectives and other characteristics.

A 'durable medium' is defined in Article 2 (18) as an instrument which:

- (a) enables a customer to store information addressed personally to that customer in a way accessible for future reference and for a period of time adequate for the purposes of the information; and
- (b) allows the unchanged reproduction of the information stored.

A PDF copy of a document setting out a suitability statement for example would meet the above requirements.

Where the contract is concluded using a means of distance communication (via, for example, the telephone or by email exchange) that prevents prior delivery of the suitability statement, the insurance intermediary or insurance undertaking can provide the suitability statement on a durable medium **immediately after** the customer is bound by any contract. However, this can only be done if both of the following conditions are met:

- The customer has consented to receiving the suitability statement without undue delay after the contract is concluded.
- The insurance intermediary or insurance undertaking has given the customer the option of delaying the conclusion of the contract to receive the suitability statement in advance.

The above requirements could be met by asking a customer to tick a box indicating consent if the exchange is via email, or by verbally recording consent if the discussion is conducted via the telephone.

Appropriateness assessment

If no advice is given during the sale of an IBI product, the insurance intermediary or insurance undertaking must ask the customer or potential customer to provide information regarding that person's knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded.

If the customer does not provide the necessary information, then a warning should be given (and recorded) to confirm that the IBI product may not be appropriate.

EIOPA consultation on Guidelines on product oversight & governance arrangements

From October 2014 to January 2015, EIOPA conducted a public [consultation on Guidelines on the product oversight and governance arrangements by insurance undertakings \(CP-14/150\)](#). The paper contained provisions related to the manufacturers of insurance products in Chapter 1 and provisions on insurance distributors, which have been added in Chapter 2.

[The EIOPA Guidelines, which were finalised in April 2016](#), provide high-level expectations on IDD requirements and should be adhered to given they are designed to prevent mis-selling. However, the Guidelines will look very familiar to UK distributors and issuers.

Contacts:



Katherine Coates
Partner

T: +44 20 7006
1203

E: Katherine.coates@cliffordchance.com



Hilary Evenett
Partner

T: +44 20 7006
1424

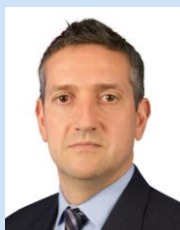
E: Hilary.evenett@cliffordchance.com



Alex Erasmus
Partner

T: +44 20 7006
1344

E: Alex.erasmus@cliffordchance.com



Ashley Prebble
Partner

T: +44 20 7006
3058

E: Ashley.prebble@cliffordchance.com



Narind Singh
Partner

T: +44 20 7006
4481

E: Narind.singh@cliffordchance.com



Clare Swirski
Partner

T: +44 20 7006
2689

E: Clare.swirski@cliffordchance.com



Amera Dooley
Professional Support
Lawyer

T: +44 20 7006
6402

E: Amerna.dooley@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ
© Clifford Chance 2015

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571

Registered office: 10 Upper Bank Street, London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

www.cliffordchance.com

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta* ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Linda Widyati & Partners in association with Clifford Chance.