

Insurance Distribution Directive - Briefing

Background

The Insurance Mediation Directive (IMD) came into force in the UK on 14 January 2005. It specified conditions for the initial authorisation and ongoing regulatory requirements for insurance and reinsurance intermediaries. It was designed to encourage cross-border competition between intermediaries and also to ensure appropriate levels of protection for insurance customers across the European Union (EU).

The EU Commission (“the Commission”) completed an IMD implementation check in 2008 which identified the need to review the IMD. This process began in 2010 and resulted in a proposal for a re-cast directive (then known as IMD2) in 2012. This has now been amended and renamed the Insurance Distribution Directive (the IDD). The IDD came into force on 23 February 2016 and the UK is required to comply with the IDD by 23 February 2018 and it will be fully implemented into UK law regardless as to the fact the UK is leaving the EU.

The FCA are currently consulting on some of the new requirements imposed by the IDD [CP17/7: Insurance Distribution Directive Implementation](#). Consultation closes on 5 June 2017.

This consultation paper covers the following:-

- application of the Directive;
- professional and organisational requirements;
- complaints handling and out-of-court redress;
- changes to conduct of business rules (for non-investment insurance contracts);
- the regulatory regime for Ancillary Insurance Intermediaries.

A second consultation paper will be issued later this year (Q3) which will cover the following:-

- the requirement for non-life insurance distributors to provide the customer with a standardised Insurance Product Information Document (IPID);
- the approach to the conduct of business requirements for life business, including insurance-based investment products (IBIPs): and
- product oversight and governance.

Proposed Changes – Non-ICOBS

- IDD introduces a minimum of 15 hours continuing professional development (CPD) for all staff involved in insurance distribution and to ensure that firms have records in place to evidence a member of staff’s competence to undertake the role;
- Increase in PII cover;

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- Insurance intermediaries and insurers must only use authorised or exempt firms for the entire length of any distribution chain;
- Increase in capital resource requirements for insurance intermediaries; and
- Minor changes to complaint process.

Conduct of Business Changes

The main changes are in relation to conduct of business rules. This consultation paper focuses in ICOBS but it is likely that there will be similar proposal for COBS.

The IDD general principles

The IDD introduces general principles that apply to all insurance distributors and are similar to the current FCA Principles for Business. These Principles apply to all firms involved in the distribution chain and not just those with direct contact with the customer (wholesalers are therefore caught). In summary, the IDD general principles are:-

- Distributors must act honestly, fairly and professionally in the best interests of their customers;
- Distributors must communicate in a way which is clear, fair and not misleading, including ensuring that marketing materials are clearly identifiable as such;
- Remuneration of a distributor or its employees, and performance management of employees, must not conflict with the duty to act in the customer's best interests. The IDD definition of 'remuneration' includes commission, fee, charge or other payment, including an economic benefit of any kind or any other financial advantage or incentive offered or given in respect of the insurance distribution activity.

The FCA propose to:-

- include a new rule in ICOBS requiring insurance distributors to act honestly, fairly and professionally in the best interests of their customers ('the customer's best interests rule');
- amend the current ICOBS rules on communications and financial promotions to require that all marketing communications be clearly identifiable as such;
- include a new rule in SYSC to prohibit remuneration and performance management practices that would conflict with the customer's best interests rule.

General pre-contract disclosures

The IDD builds on the existing pre-contract information requirements currently in place. The new requirements are:-

- The pre-contract disclosure regime now applies to insurance undertakings;
- Firms must state what type of firm they are (an intermediary or an undertaking);
- Firms must state whether they provide a personal recommendation;
- Insurance intermediaries must state whether they are acting on behalf of the customer or the insurance undertaking.

Disclosures relating to conflicts of interest and transparency

The IDD builds on the existing conflicts of interest disclosure requirements in ICOBS. The IDD requirements apply only to insurance intermediaries:-

- Intermediaries must disclose if they have 10% or more voting rights or capital in an insurer, or vice versa. Currently the requirement is “more than 10%”;
- Intermediaries must disclose if they give advice based on “a fair and personal” analysis of the market;
- Where an intermediary is contractually bound to place business with a specific insurer or insurers it must provide the names of these insurers. Currently this information need only be supplied on request by the customer;
- Where an intermediary is not contractually bound to place business with specific insurers but does not provide advice on the basis of a fair and personal analysis of the market, it must name the insurers with whom it may place business. Currently this information need only be supplied on request by the customer.

The IDD requirements relating to disclosure of remuneration arrangements of firms

The IDD introduces new requirements for the pre-contract disclosure of information about an insurance distributor’s remuneration and requires insurance intermediaries to disclose the “nature and basis” of the remuneration they receive in relation to the insurance contract.

Insurers must likewise disclose the “nature” of the remuneration paid to their employees.

Where the remuneration is in the form of a fee paid by the customer, the exact amount of that fee must be disclosed. Firms are permitted to disclose the method of calculation instead of the actual amount, but only if the amount cannot be calculated at the time.

The FCA view “nature” as requiring firms to disclose the type of remuneration they will receive or pay. This could be a basic commission, bonus, profit share or other financial incentive.

The FCA view “basis” as requiring firms to disclose the source of the remuneration they receive. Where an intermediary gets paid commission it will not be sufficient to state that they receive commission from an insurer as the actual source will be the premium.

Compliant disclosure would be:-

“We arrange the policy with the insurer on your behalf. You do not pay us a fee for doing this but we receive commission from the insurer which is a percentage of the total annual premium.”

Means of providing information

The IDD sets out new provisions on how information must be provided to customers. In summary, the requirements are:-

- All the information required must be provided:
 - in a clear, accurate and comprehensible manner;
 - in an official language of the Member State, and;
 - free of charge

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- Information may be provided on paper, a durable medium other than paper or a website (where it is not a durable medium and satisfies certain conditions). Where information is provided through a medium other than paper, the option to have the information on paper must be available and free of charge.
- There is no provision for the information to be provided orally at the request of the customer.
- Telephone sales should comply with existing EU law in relation to distance marketing.

Advised and non-advised sales

The IDD builds on and amends the existing ICOBS standards for advised and non-advised sales. All firms are required to identify their customers' insurance demands and needs, and ensure that insurance contracts proposed are consistent with them. Where a firm provides advice, it must explain why a contract best meets the customer's needs.

The IDD also contains the provisions relating to product information and the Insurance Product Information Document (IPID). Further information on this will be in the second consultation paper.

Demands and needs

The IDD makes it clear that firms need to specify the customer's insurance demands and needs based on information obtained by the firm from the customer and therefore must take an active role in identifying the customer's demands and needs (through asking questions).

In addition the IDD includes an additional provision that "any contract proposed shall be consistent with the customer's insurance demands and needs" meaning that firms must only offer contracts that meet the customers' demands and needs.

To comply with this additional requirement, firms need to take two steps:-

1. Identify the customer's demands and needs, and match them to the available products, and
2. State the customer's demands and needs to assist them in making an informed decision.

There is still a need to retain a clear distinction between advised and non-advised sales. In relation to non-advised retail sales, the FCA would not expect firms to carry out a detailed investigation of the customer's circumstances, but they should identify their demands and needs, and ensure that the contracts proposed provide cover that meets those demands and needs. Firms may therefore need to ask additional questions to ensure that they are able to limit their product offering to those which would meet these specified demands and needs.

Where the sale is advised, the FCA propose to include a new requirement for firms to provide a personalised explanation why the proposed product best meets the customer's insurance demands and needs and for firms to match the customer's demands and needs to the available products, and set out a personalised explanation of why the product proposed best meets those needs. If the firm does not offer a product which meets the customer's needs it should say so.

Cross-selling

The IDD introduces new requirements for the cross-selling of insurance products. These requirements apply where an insurance policy is sold in connection with, or alongside, other goods or services as part of a package or the same agreement.

In packages where insurance is the primary product, information must be given on whether the different components of the package can be bought separately. The distributor must also provide an adequate description of the component products, explain any interactions between the components, and provide separate information on the costs and charges.

In packages where insurance is ancillary to other goods or service the customer must be able to buy the primary product or service without the insurance.

Ancillary insurance intermediaries

The IDD introduces AIs as a new category of insurance intermediary. These are firms who meet the following requirements:

- The firm's principal professional activity is not insurance distribution, and
- The firm only distributes insurance products which are complementary to goods and services they provide as their primary professional activity.

The IDD does not require the direct regulation of AIs whose insurance distribution activities are limited to products which meet particular criteria (exempt firms).

The FCA have three categories of AI:-

- "In-scope AIs" – firms who meet the definition of being an AI and are within the UK's regulatory perimeter. This includes firms within scope of the Directive and firms such as motor vehicle dealers whose insurance distribution activities may be outside of the IDD but who are within the UK regulatory perimeter.
- "Connected travel insurance (CTI) providers" – firms whose primary business is to make travel arrangements for customers, but who distribute insurance that is complementary to those services, such as travel agents, tour operators and airlines. The distribution of CTI contracts was brought into FSMA regulation subsequent to the IMD implementation and is currently subject to a different regulatory regime.
- "Out-of-scope AIs" – firms who are outside the UK regulatory perimeter. Common examples include electronic goods and furniture retailers.

For AIs requiring regulation under the IDD, most requirements apply, although there is a slightly reduced information disclosure regime.

For insurers and insurance intermediaries distributing products through out-of-scope AIs, the IDD requires them to ensure that:-

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- prior to the conclusion of the contract information is made available about the identity and address of the authorised insurer or intermediary, and its complaints procedures.
- there are ‘appropriate and proportionate’ measures in place:
 - to comply with the general requirement of acting honestly, fairly and professionally in the customer’s best interests, requirements relating to communications, and the restriction on remuneration practices;
 - to comply with the rules concerning cross-selling;
 - to consider the customer’s demands and needs. In our view, this means that the firms must identify the customer’s demands and needs, and ensure that contracts proposed are consistent with those demands and needs.

The FCA view is that these represent the IDD minimum requirements for Alls. This is because all Alls are required to comply with these requirements, regardless of whether they are in-scope or out-of-scope.

Branko Ltd provides general insurance FCA compliance consultancy, support services, general management consultancy and project management.

For FCA work all advice given is based upon our current understanding of the regulations and the regulators’ normal practice as at the date of any report or recommendations. As regulation is a dynamic process, any advice given must be reviewed from time to time to ensure that it remains appropriate and up to date.

Current hot topics include evaluation of Conduct Risk, implementation of the Insurance Distribution Directive and effective complaints management. Please contact us to discuss your own individual needs.