EUROPEAN COMMISSION

MEMO

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Revision of the Insurance Mediation Directive - Frequently Asked Questions

1. What is insurance mediation?

Insurance mediation means:

- the act of advising on, proposing, or carrying out any other work preparatory to the conclusion of insurance contracts, or of concluding such contracts, and
- the act of assisting in the administration and performance of insurance contracts, in particular in the event of a claim.

2. What is the Insurance Mediation Directive (IMD) about?

The current IMD regulates the selling practices of all insurance products. It covers the regulation of general insurance products such as motor insurance as well as life insurance policies including those which contain investment elements such as unit-linked life insurance products.

3. Why does it need to be revised?

The financial crisis has underlined the importance of ensuring effective consumer protection across all financial sectors, which can only be achieved with proper regulation and supervision of all financial service providers and agents that deal directly with consumers.

Adopted in 2005, the IMD contains principles that each of the 27 Member States has implemented in substantially different ways. Certain parts of it are in need of modification or clarification, and some important matters proposed today do not fall within its current scope.

Strong concerns have been raised about standards for the sale of life insurance products with investment elements (e.g. unit-linked contracts). Currently, less strict standards apply to those products than to non-insurance investment products (regulated under the Markets in Financial Instruments Directive (MiFID), currently under revision – see IP/11/1219 and MEMO/11/716). This means that there is cross-sectoral inconsistency, since market participants are offering insurance-based investments in place of other investments.

Concerns have also been raised about the limited scope of the IMD, particularly that it does not regulate direct selling – that is sales of insurance products directly by insurance undertakings (without the intervention of intermediaries)- so there is not a level playing field for all players involved in the selling of insurance products.

4. How is this revision relevant for the economy?

The revision of the IMD is part of a 'Consumer retail legislative package', together with the PRIPs (Packaged retail investment products) proposal on investment products' disclosures and UCITS V (Undertakings for Collective Investment in Transferable Securities) (see IP/12/736) and aims to:

- 1. Improve competition and create a level-playing field in the insurance markets.
- 2. Provide European consumers with better advice on the insurance products most suited to their needs, and clear information in advance on the status of the people who sell the insurance product and the remuneration which they receive.
- 3. Introduce simplified, less burdensome rules on free provision and establishment of insurance services. The new directive foresees the establishment of a single European registry for insurance intermediaries who want to provide cross-border services.

5. What exactly will change?

Currently, only agents and brokers are covered by the IMD. With the new proposal:

(1) The scope of the revised IMD will be extended to all sellers of insurance products, including insurance companies that sell directly to consumers. Other market players who sell insurance products on an ancillary basis (e.g. car rental companies) will be included in a proportionate manner in the scope of the revised IMD.

(2) Rules that address more effectively the risk of conflicts of interest, including rules mandating the disclosure of remuneration by intermediaries, will be introduced.

(3) Improved requirements would apply to life insurance products with investment elements, covering sales standards, conflicts of interest, and a ban on commission for independent advice.

(4) There would be mutual recognition of professional knowledge and ability, as evidenced by registration and proof of professional qualifications acquired in another Member State.

(5) Special information requirements would apply where suppliers adopt the practice of bundling products together by informing the customer that it is possible to buy the two products separately.

(6) Effective, proportionate, and dissuasive administrative sanctions and measures by competent authorities in respect of breaches would be required by providing guidelines to Member States.

6. What does a seller of insurance products need to disclose? How will the transparency rule work in practice?

The IMD revision proposes several improvements to deal with conflicts of interest between the seller of the insurance product and the potential client.

For instance, customers need to understand the status of the person who sells the insurance product. The salesperson will thus have to clearly demonstrate the role in which he is acting (agent, broker, direct writer, etc.) by presenting a business card when selling the product.

The seller will need to **disclose the nature** (based on a fee, commission or salary) **and the structure** (financed directly by the client or an undertaking) **of his /her remuneration** and what the premium encompasses in terms of services (claims handlings, advice, administration, etc.). At the same time, rules will be introduced to more effectively address the risk of conflicts of interest, including disclosure of remuneration by intermediaries.

7. What is the difference between mandatory disclosure and on-request disclosure? How is this regulated in different Member States? How the transitional period will work?

"***Mandatory disclosure of remuneration***" means that the intermediary should disclose his remuneration to the customer. "***On request regime***" means that the intermediary needs only to disclose his remuneration if a customer specifically requests so.

The situation is very different in Member States. Some Nordic markets (Finland and Denmark) have prohibited intermediaries from receiving commissions from insurance firms, and therefore went further than introducing simple transparency requirements. Other countries (such as Sweden and the UK) already require mandatory disclosure for some insurance policies.

As for the remuneration disclosure, the Commission proposes a five-year transitional period. This means that a mandatory 'full disclosure' regime is envisaged for the sale of life insurance products and an 'on–request' regime (i.e. on customer's demand) for the sale of non-life products with a transitional period of five years. After the expiry of this transitional period, the full disclosure regime will automatically apply for the sale of non-life products as well. This timeframe is long enough to allow SMEs to prepare and adjust their practices to the legislative change and to measure the impact of the suggested change in practice, whilst it is sufficiently short to put a full system in place in the foreseeable future**.** There is also a process for review and evaluation by the Commission of the Directive after its entry into force. This review shall in particular consider the impact of these disclosure rules on non-life insurance intermediaries that are small and medium-sized undertakings.

8. Do the new rules recognise the difference between non-life/pure life insurance products and life insurances with investment? How will national differences in insurance distribution be taken into account?

Some investment products are packaged as life insurance policies. These are high-risk products. The IMD revision introduces a more stringent regime for the selling practices of those products (life insurance policies with investment elements). Thus, the customer buying such a product will obtain information about the product's insurance coverage as well as the investment risks related to it. Enhanced requirements would apply to the sale, covering sales standards, conflicts of interest, and a ban on commissions for independent advice.

For non–life or pure life insurances, the new IMD would continue to have the features of a "minimum harmonisation" legal instrument at European level. This means that there is the possibility for Member States to impose stricter requirements.

For life insurance products with investment elements, a new chapter will be introduced. This chapter refers to additional, stricter conduct of business requirements for those who sell life insurance policies with investment elements and will contain conduct of business rules similar to those laid down by MiFID II.

9. Will the revised Directive apply to all market players? What will the main changes be for travel agents, car rental companies or loss adjusters or example?

Yes, it will apply to all market players.

The directive will apply to direct sellers (insurance undertakings) and will cover providers of after-sales services (such as loss adjusters).

Conversely, certain intermediaries selling insurance on an ancillary basis, or carrying out after-sales services, could use (instead of registration) a simple declaration procedure with lighter information and organisational requirements under the supervision of an insurance undertaking or registered intermediary.

10. Who will benefit and how? What are the costs and benefits of the proposed revision?

Consumers will benefit from the increased scope of the directive, which will ensure that they are protected no matter which sales channel they chose when buying insurance. They will also benefit from the enhancement of existing sales standards and the extension of those standards to new areas of protection, for example new regulations requiring that insurance sellers disclose conflicts of interest. By introducing improved and harmonised advice standards, consumers benefit by being able to compare offers in a simpler manner, even gaining the ability to compare offers across different distribution channels. This is likely to lead to an improved understanding by consumers of the services and products on offer. As a result, consumers will be inclined to compare offers and shop around for products and deals better suited to their needs. This reduces the cost paid by the consumer.

The benefits of a more stringent regime and increased consumer protection standards can be represented by calculating the reduction of "consumer detriment" ("consumer detriment" is calculated on the basis of the number of cancellations of life insurance policies before they mature, i.e. "early withdrawal" when consumers have bought products that are not suitable for their needs). Since consumer detriment could reach up to €1 trillion for EU27, only counting the sale of unit-linked insurance products, one can assume that even if a small percentage of reduction of consumer detriment could be attributed to improved regulatory standards, this small percentage will still represent a very high figure of benefits which greatly surpasses the proposal's administrative costs.

European insurance businesses will also benefit from greater consumer confidence and expanded business opportunities, including greater options for cross-border sales. Lower costs of operating cross-border and higher consumer confidence (and therefore demand) will increase sales. This should increase competition between sellers and spur positive innovation in the industry. Similar impacts could be expected from policy options that encourage insurance intermediaries' cross-border activity.

The current total costs to companies and authorities is estimated to be, in view of the large number of undertakings affected (about 1 million), a relatively moderate cost averaging about €730 per undertaking. Those costs will not be distributed equally between all undertakings – undertakings selling life insurances with investment elements will be affected more than those undertakings that only sell general insurance products.

11. Will SMEs benefit from the revision of the current rules?

SMEs which carry on insurance mediation as their principal business are already subject to the IMD. Accordingly, they are currently subject to requirements such as good reputation, competence, disclosure of status and whether advice is given and on what basis. Some 48% of sales are currently covered by the IMD – a percentage that will increase to 98% under the new proposal. The increase is mainly due to the inclusion of sales by insurance undertakings, which do not classify as SMEs under other directives (Solvency II).

The intermediaries which are SMEs and are currently outside the IMD's scope will be brought into its scope by this proposal. They are essentially businesses whose principal activity is other than insurance mediation (so this activity is purely ancillary to their main business). These intermediaries will be subject to a lighter regime as a proportionate approach to the ancillary nature of the mediation they perform.

Proportional requirements have been introduced to take account of SME concerns and to respect the principle "less complex products, less complicated rules".

12. When will the new rules come into force?

Before the new rules can come into force, the proposal must first be adopted by the European Parliament and the Council. This is likely to happen during 2013. Work on subsequent technical measures to give effect to a number of provisions would start soon thereafter, with an entry into force most likely in 2015.

13. Tangible Changes: examples of how IMD will help consumers

Hungary – In Hungary, only 17% of consumers interviewed said they relied on professional advice when buying insurance. This is emblematic of the lack of trust that pervades the insurance services market. Few consumers actually trust those intermediaries or financial advisers who ought to be in place to help them. According to a 2008 study led by AVIVA[1], nearly 50´% of all consumers interviewed relied on recommendations made by friends and family, meaning that significantly more consumers rely on informal sources of advice rather than professional sources. This contributes to the general lack of information that pervades the insurance sector.

[1] Aviva survey on consumer attitudes: http://www.aviva.com/customers/consumer-attitudes-survey

How would the IMD Revision help in this situation? Up until now, the vast majority of Member States (21 out of 27) have not instituted any requirements obliging intermediaries to disclose their remuneration or their relationship to the direct writers of the insurance product. The revised IMD would make it mandatory for intermediaries to inform their customers of this information. Ideally, this will help instil trust in consumers and encourage them to seek professional advice. The Commission's proposal also ensures that should a consumer seek advice, that advice will be honest and unbiased as a general principle, the intermediary needs always to act in the best interest of his customer. The combination of these policies will pave the way for increased consumer trust in reliable, helpful sources of information, resulting in a greater number of safer and more informed insurance product purchases.

The Netherlands – Recently, consumers in the Netherlands filed a class action lawsuit over the mis-selling of equity-linked insurance products. The consumers claimed that the insurance sellers did not sufficiently disclose the costs associated with those policies, so investors were met with far lower investment returns than they had been led to expect, in addition to finding that there were penalties on early withdrawal – penalties that the insurance sellers had also failed to notify them of. This is a problem that affects the entire EU: for EU27, the potential consumer detriment stemming from the sales of unsuitable life-insurance products could be as great as € 1.1 trillion.[2]

How would the IMD Revision help in this situation? Differences in regulation between life insurance products and mutual funds have caused significant problems for consumers. Currently, less strict standards apply to those products than to non-insurance investment products. The IMD revision proposal aims to address this grey area by clearing up the regulations surrounding life insurance products ad explicitly delineating the rules regarding them. The IMD revision proposal also states that all information regarding such insurance products must be fully disclosed and clearly presented by their sellers to consumers.

[2] Commisison impact assesment on IMD, Executive Summary.