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**COMMISSION STAFF WORKING DOCUMENT**

**EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT**

*Accompanying the document*

**PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF  
THE COUNCIL**

**on Insurance Mediation**

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#### on Insurance Mediation

#### 1. OVERVIEW OF RELEVANT EU LEGISLATION AND CURRENT POLICY INITIATIVES

	Insurance	Investment	
Relevant products	life insurance, motor insurance, liability insurance, property insurance, cargo insurance etc. as well as insurance products with investment elements, such as unit-linked life insurance.	shares, bonds (including structured bonds), investment funds, derivatives, etc.	
Capital requirements	SOLVENCY II taking up and pursuit of business, supervision, reorganisation and winding-up procedures for insurance and reinsurance companies	CRD (Capital Requirements Directive) IV taking up and pursuit of business, supervision, reorganisation and winding-up procedures for credit institutions and investment firms	
Distribution	IMD Registration and authorisation rules (including qualification of staff), selling practices of <u>all insurance products, cross-border, conduct of business, supervision, etc. Sales of insurance products with investment elements, such as unit-linked life insurance are regulated under IMD.</u>	MiFID II Registration and authorisation rules, organisational requirements (including qualification of staff), selling practices of all <b>investment</b> products, cross-border, conduct of business, supervision, etc. <u>MiFID has an exemption for investment products with an insurance wrapper, such as unit-linked life insurance.</u>	
Product disclosure	SOLVENCY II Insurance products	PRIPS Insurance products with investment elements	UCITS Investment products

In order to ensure cross-sectoral consistency, the revision of the IMD will take into account the on-going revision of MiFID as well as the upcoming PRIPs initiative. It means whenever the regulation of selling practices of life insurance products with investment element (PRIPs insurance) is concerned, IMD should meet at least similar consumer protection standards as the revised MiFID. PRIPs insurances are retail investment products packaged as life insurance, such as unit-linked life insurance for example.

## 2. PROBLEM DEFINITION

The outstanding issues with the current IMD legal framework, which will be detailed further in this section, can be grouped into two problem categories: problems related to the sale of all insurance products (life and non-life insurances) and problems related to the sale of PRIPs insurances.

### 2.1. Problems related to the sale of all insurance products

The scope of the Directive does not include direct writers and some other sales channels of insurance products (such as travel agencies and car rental companies). This leads to a widespread problem that consumer protection is different depending on where (through which sales channel) the consumer purchases an insurance product. Besides undermining consumer protection, this situation also creates unequal regulatory compliance costs across sales channels. Some after-sale market players (claims handlers and loss adjusters) are also excluded from the scope of IMD at present. These professions make part of the sales process of the insurance products and could be exposed to conflicts of interest.

The second substantial problem relates to conflicts of interest between the seller of insurance products and the consumer due to the remuneration structures of sellers. Conflicts of interests stemming from remuneration structures can lead to consumer harm in two slightly different ways: either through a lock-in of the intermediaries into quasi exclusive dealing arrangements with a single upstream insurance company (whereby consumers turning to the intermediary will not have sufficient choice to best satisfy their needs); or through advising products to the consumer which are the best remunerated for the seller, rather than best suited to consumers' needs (this latter case is dealt with below, together with other problems concerning advice).

The third group of important issues relate to advice, where we can distinguish two different problems.

- *Biased advice* could be given to consumers due to the above described conflicts of interest stemming from remuneration of sellers.
- *Low quality advice* occurs in areas where the professional qualification requirements for sales personnel are insufficient. Currently the rules of professional qualifications vary widely across Member States and across sales channels, leaving many consumers with low quality of advice.

Access to cross-border markets is burdensome for sellers of insurance products and currently there is very little entry across European markets. Mutual recognition of professional qualifications, freedom to provide services and freedom of establishment are not specified in the text of IMD1. There is no single register where consumers could find information about the sellers of insurance products in every EU Member State.

With regards to the problem with lack of harmonisation of sanctions, it has been detected as an issue in almost all current revisions of financial services legislation. The reason for that is lack of deterrent effect of sanctions in some Member States and large differences between the sanctioning powers of the competent authorities.

## **2.2. Problems related to the sale of PRIPs insurances**

Consumer protection standards for the sale of insurance PRIPs are not sufficient at EU level as IMD 1 does not contain special rules for the sale of complex life insurance products with investment elements. Currently, those products are sold under the general rules for the sale of insurance products although these products are very different in nature and represent higher risks for unprofessional buyers. There is market evidence of a very high number of complaints regarding the sale of unit-linked insurance products in many Member States. There is evidence about regulatory arbitrage existing due to differences in the regulation of the sale of PRIPs through different sales channels. The potential consumer detriment stemming from the sale of unsuitable unit-linked life insurance products could be estimated to be a maximum of €1.1 trillion for EU 27. Importantly, in the insurance market, due to costs of exit and higher costs of products - unsuitable advice can lead to investors paying more in fees and being locked into products with penalties for leaving that were not understood well enough by the investor when making the investment. Of course, many factors impact on actual detriment for consumers, and sales advice is only one factor. However evidence suggest that advice is crucial in retail markets of financial products. Therefore, it appears that advice is a key element. Given the size of this market the mis-selling cases could equate to a large potential impact on consumer welfare. In the absence of EU rules, regulators have responded by asking for increased cost transparency or, where their action captures complex products in general, providing guidance on pre-contractual disclosure or calling for a moratorium on the sale of such products.

## **3. ANALYSIS OF SUBSIDIARITY AND PROPORTIONALITY**

Member States acting on their own would not be able to address at national level the problems of ineffectiveness due to different regimes for direct writers and intermediaries across the EU, non-harmonised standards of advice and consumer protection and differences in qualification requirements. Moreover, the revision of the existing Directive aims to improve consumer mobility, to facilitate cross-border trade and to ensure a level playing field for all market players by aligning the regulatory standards in different financial services sectors (i.e. aligning IMD with MiFID rules on sales of insurance policies with investment elements).

About 95% of registered insurance intermediaries in the EU are micro enterprises and SMEs (as defined by other EU Directives). Therefore, a proportionality approach needs to be ensured when introducing aligning IMD with MiFID.

1. The sellers of simple insurance products who sell insurance products on an ancillary basis (such as car rentals, travel agents) and the after-sales services (such as loss adjusters and claims managers) will go through a simplified notification procedure instead of registration with the competent authorities.
2. There will be a general proportionality rule applicable to all provisions which states that, since the Directive is a minimum harmonisation instrument, Member States should impose requirements in a proportionate manner taking into account the

complexity of the products sold. This would equally apply to EIOPA when it develops Level 2 measures on professional qualification requirements.

3. MiFID rules pertaining to investor protection (such as the ban on commissions for independent advice, mitigation of conflicts of interest, suitability and appropriateness test) will be taken over in IMD2 to ensure a level playing field between the sales practices of all PRIIPs products in the investment and insurance fields. IMD2 and Solvency II will contain organisational rules (registration, notification, rules on internal audit, risk management, etc., – similar to those contained in MiFID) for insurance intermediaries and direct writers which will ensure equally high standards - sometimes higher - in this regard as MiFID. As these rules take organisational features of insurance intermediation and insurance into account, the administrative burden is significantly less than using full MiFID rules written for the investment sector. The countries using MiFID rules in full (NL, IT, UK) in fact apply a proportionality approach to make the rules useful and suitable for insurance intermediaries.

#### 4. COMPARISON OF POLICY OPTIONS

**Scope:** The preferred policy option is to define more precisely the activities that are within the scope of the IMD. This means maintaining the flexibility for Member States to set the widest possible scope but allowing some exceptions to ensure proportional treatment (to exempt sales of insurance complementary to the supply of goods; and to exempt large risks insurance and professional buyers from conduct of business rules). This includes also an introduction of simplified declaration requirements for actors in the insurance value chain (sellers of insurance products on ancillary basis such as travel agents, car rentals and after sales players such as loss adjusters, claim handlers). This already has beneficial impact on consumers, while the impact on market players selling on an ancillary basis would only be small in terms of costs. This option substantially reduces the negative impact on direct sellers and intermediaries in terms of competition, while still remaining effective in achieving the pursued objectives.

**Conflict of interest:** There are two preferred options: to introduce a European Business Card standard disclosure format for all the sellers of insurance products and to introduce at the same time a MiFID style regime (conduct of business rules as contained in articles 23-25 of MiFID II) for the sellers of life insurance products with investment elements. These options trigger improved consumer protection by prevention (European Business Card and disclosure of remuneration) and possible management and mitigation of conflicts of interests (MiFID-style solutions). At the same time these options are cost efficient as they allow for a proportionate approach depending on the complexity and the costs of the products sold.

**Advice:** There are two preferred options related to advice: it would be not costly to introduce a definition for advice in the Directive. This option will enable the consumer to know as to whether he receives a personalised advice or not when purchasing a product. The other preferred option is to introduce a MiFID-style suitability test and a ban on commission for independent advice for the sales of the

most complex products. This will prevent consumer detriment that might arise in cases of inappropriate selling of those products.

As for the problem of low quality advice, the preferred option is to ensure that the professional qualification of the seller of the insurance product is proportionate to the complexity of the products that he offers, for instance sellers of complex life insurance products should receive special training about the features of the products that they are offering. Due to the market structures and Member States competencies related to professional qualification requirements, this should be combined with a 'soft law' approach.

**Cross-border trade:** The preferred option is to introduce FOS and FOE definitions and a mutual recognition system, as well as a simpler notification process for those insurance intermediaries who want to sell products on a cross-border basis, as well as to create a centralised registration system where consumers can find information about all sellers of insurance products which exist in the Member States. These options are relatively cost efficient and would lead to important consumer benefits linked to having more information and a wider range of choice (improved competition).

**Sanctions:** The preferred option is to introduce a general sanction framework by establishing harmonised minimum rules which are dissuasive enough to significantly reduce the number of infringements. This option has been identified as being the most cost-effective by several impact assessments of similar legislative initiatives, such as MiFID and PRIIPs. EIOPA is also largely in favour of this approach. It should also be noted that a large number of potential offenders might be cross-border operators with very considerable turnovers, for whom a sanction of a 6 000 EUR for being an unregistered insurance intermediary (e.g. Spain) will not have a dissuasive effect.

## 5. OBJECTIVES OF EU INITIATIVE

The revision of IMD1 seeks to improve regulation in the retail insurance market in an efficient manner. It aims at ensuring a level-playing field between all participants involved in the selling of insurance products and at strengthening policyholder protection.

## 6. ASSESSMENT OF IMPACTS AND COSTS

All analysed policy options will result in Member States incurring compliance costs in terms of developing and/or incorporating rules into national law. According to a recent study, the costs of developing and/or incorporating rules into national law are low to moderate. As for administrative costs, since this initiative would by definition seek to require the application of new selling rules and in some Member States the provision of new information to retail customers, this would impose one-off costs on all distributors and manufacturers. On-going costs are also likely to occur. As for the extension of scope, this would have a marginal or no impact on direct writers and other market players. As far as distribution of PRIIPs insurances is concerned, it should be noted that an estimation of the impacts at level 1 for an initiative such as

this is necessarily going to be rather approximate; more accurate estimations will only be possible once analysis of possible level 2 measures has been undertaken. The estimate of administrative burden on the basis of the PWC study and industry statistics, adjusted by Commission services, are around 617.000.000 EUR for the first year of application of IMD2, which represents 0,06% of the total GWP for 2009 and will result, in view of the large number of undertakings affected (about 1 million), in a relatively moderate cost **on an average of about 730 euro per undertaking**. Those costs will not be distributed between all undertakings in an equal manner – those undertakings selling PRIPs insurances will be affected more than those who only sell general insurance products.

## **7. ESTIMATION OF BENEFITS**

### **7.1. For consumers and society**

By introducing improved and harmonised advice standards, consumers will gain benefits through an improved comparability of offers, including 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/price paid by the consumer.

The consumer needs to buy insurance policies which fit his needs and financial situation. Otherwise, there is a high risk of an early withdrawal on the unsuitable policy and consumer dissatisfaction. This means that if a consumer cancels his/her insurance contract earlier, he or she will lose all accumulated benefits and pay around 8% cancellation fees. There may also be some unfavourable taxation consequences for the consumer following a cancellation of a life insurance policy (for example if taxation has to be levied on any surrender value of the policy). For instance, for the market of one type of life insurance products, variable annuities statistics suggests that in about 25% of cases consumers withdraw from the contracts before they mature (level of 'defaults'). This could be linked to various factors, *inter alia* inappropriate advice on the choice of the product. The benefits to consumers and society as a whole from the introduction of high and harmonised advice standards come through a reduction in early withdrawals (reduction in defaults).

### **7.2. For sellers of insurance products**

The main benefits for insurance intermediaries and insurance companies will be in the form of greater business opportunities. These would stem from lower costs of operating cross-border and higher consumer confidence and therefore demand. This should increase competition between sellers. Similar impacts could be expected from policy options that encourage insurance intermediaries' cross-border activity.

With regards to the effect of improved advice standards, market players will save on some additional costs linked to defaults. These include costs linked to re-calculations and calibrations of risk management measures by insurers, which must manage a wide range of risks under a long-time investment perspective. Finally, market actors should also benefit from enhanced financial market stability.

### **7.3. For Member States**

Insurance plays an important social role since it covers risks which are difficult or impossible to be faced by citizens under normal circumstances. Member States might face lower costs and thus benefits because reduced sales of unsuitable insurance products leading to earlier cancellation of the policy would mean lower costs in terms of providing assistance for consumers who are unable to absorb losses of their assets and increased expenses incurred through mis-sales in insurance policies (e.g. life insurance, unemployment insurance, home insurance, medical insurance).

## **8. MONITORING AND EVALUATION**

In order to evaluate whether the preferred policy options have achieved their objectives, the Commission services envisage to work closely with EIOPA, consumer groups (e.g. FSUG), main stakeholders and Member States. An ex-post evaluation is to be performed five years after the adoption of the revision of the Directive.