Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Consumer Panel response to consultation document on the Review of the Insurance Mediation Directive

The Financial Services Consumer Panel was established under the Financial Services and Markets Act 2000 by the Financial Services Authority to represent the interests of consumers. The Panel is independent of the FSA. The main function of the Panel is to provide advice to the FSA, but it also looks at the impact on consumers of activities outside the FSA's remit. The Panel represents the interests of all groups of consumers.

This is the Panel's response to the consultation document on the Review of the Insurance Mediation Directive (IMD). The Panel has also responded to the review of the Markets in Financial Instruments Directive (MiFID) and the consultation on legislative steps for the Packaged Retail Investment Products (PRIPS) initiative.

Overview

The Panel is pleased to have this opportunity to respond to the review of the Insurance Mediation Directive. We support many of the proposals within the paper – including the adoption of MiFID as the benchmark for sales of insurance based PRIPS - and we are also calling for the introduction of a general overarching principle that advisers and sales staff act in the best interests of their clients. This, together with greater pre-sale transparency around remuneration and conflicts of interest, should go some way towards ensuring a fairer market for consumers.

The diverse nature of markets and products in Member States means that we have called for a minimum harmonisation approach in this review. While it is important that consumers can be confident of a set of minimum standards in terms of sales procedures and protection measures, national regulators must have the flexibility to apply tailored requirements where circumstances demand.

The IMD review, which is being undertaken alongside the MiFID review and new proposals for PRIPS disclosure, seems likely to result in fairly radical changes to the retail investment and insurance markets. We believe it is important that the Commission approves at the outset a comprehensive post implementation review to assess in particular the impact on consumer outcomes, including any rise in the cost of products and advice.

We have set out below our answers to the specific questions contained within the paper.

Specific issues

A high and consistent level of policyholder protection embodied in EU law

“It would appear logical to require similar requirements from insurance undertakings and insurance intermediaries when distributing insurance policies, taking into account the specificities of existing distribution channels.”

Questions

A 1. Do you agree with the Commission services general approach outlined in the box above? Should information requirements as contained in Article 12 of the IMD be extended to direct writers taking into account the specificities of existing distribution channels?

We agree that information provided by direct writers/product providers should be fair and not misleading as well as being provided in a clear, comprehensible and accurate manner. The specific requirements imposed on product providers should be consistent with the nature of the sales process.

A 2. Should the exemption from information requirements for large risk insurance products as laid down in Article 12 (4) of the IMD be retained? Please provide reasons for your reply.

The Panel is not in a position to comment on the retention of the exemption.

A 3. In the context of the information requirements for the mediation of insurance products other than PRIPs, do you think that the possibility for Member States to impose stricter requirements should be maintained? Please provide reasons for your reply.

Yes. We do not think that there is any evidence to suggest that maximum harmonisation would lead to increased levels of cross-border sales, as national contractual and legal differences will remain. We would favour the establishment of a set of minimum standards for both PRIPS and non-PRIPS insurance products, to be applied and enforced in all Member States. It is important that national regulators have flexibility to impose requirements that are appropriate to particular national markets and/or products.

A 4. In the context of the information requirements, do you think a definition of "advice" should be introduced? Please provide reasons for your reply.

The introduction of a definition of advice would be helpful in providing greater clarity for both consumers and firms about the procedures and rights and responsibilities that apply to advised and non-advised sales. We have no evidence however about the level and nature of any difficulty that the absence of a definition has caused to date.

A 5. If you think that a definition of advice is needed for the mediation of insurance products other than PRIPs, would a definition similar or identical to the definition in MiFID12 be appropriate? Please provide reasons for your reply.

Generally we believe that the MiFID12 definition would be a useful starting point, although we would not wish to see a definition imposed that hindered the development of restricted or limited forms of advice that could be used for the 'guided sales' of certain more straightforward products. Discussions are continuing in the UK about the development of such a service (simplified advice) which would have the benefit of meeting specific customer needs at a reasonable cost.

A 6. Do you consider that certain insurance products (other than PRIPs) can be sold without advice? If yes, which products would you have in mind and how could possible detriment for consumers be mitigated?

In our view both PRIPS and non-PRIPS products can be sold without advice to consumers who are able and prepared to make their own decisions about which products would meet their needs. The possible detriment to consumers of 'execution only' sales could be

mitigated by the use of decision trees – although we would wish to see detailed proposals before commenting more fully – and we recommend the use of post-implementation reviews as a means of assessing whether any large scale mis-selling has taken place in particular sectors. The results of these reviews could then be used to refine the relevant regulatory requirements and to ensure appropriate redress where needed.

A 7. What practical measures could be envisaged for reducing the administrative burden in this area?

The Panel is not in a position to respond to this question.

Effective management of conflicts of interest and transparency

"The current provisions in the IMD would not appear sufficiently clear and effective to mitigate significant conflicts of interest. Therefore, it would appear appropriate to revise the current rules.

The application of the high level principles concerning conflicts of interest and transparency both to insurance intermediaries and insurance undertakings could be considered.

In this context, one option could be to use the MiFID Level 1 regime as a starting point for the management of conflicts of interest, notably with regard to remuneration. In addition, requirements regarding the disclosure of remuneration could be introduced."

Questions

B 1. What high level principles would you propose to effectively manage conflicts of interest, taking into account the differences between investments packaged as life insurance policies and other categories of insurance products?

and

B 2. How could these principles be reconciled for all participants involved in the selling of insurance products?

and

B 3. Do you agree that the MiFID Level 1 regime could be regarded as starting point for the management of conflicts of interests? If not, please explain why.

We believe that the same overall approach applies to the management of conflicts of interest for both PRIPS and non-PRIPS products. The approach starts with all firms being required to have arrangements in place for identifying potential conflicts of interest and for making them known to customers before any sale has taken place. But disclosure in itself is not a means of managing conflicts, firms must go on to ensure that the existence of the conflict does not result in advice being given and products being sold that are not in the best interests of the customer. We support the read-across of the MiFID Level 1 regime as a useful basis for the development of requirements for the management of conflicts of interest under the IMD and we urge the Commission to consider a wide definition of 'incentives', which includes all forms of non-monetary incentives such as event sponsorship and paid holidays. Nor should the conflicts of interest resulting from sales/volume-driven remuneration packages within product providers as well as advisers be overlooked.

The Commission's research into consumer decision-making in retail investment services[1] contains useful information about consumer reaction to the disclosure of conflicts of interest, which further demonstrates the need for complete transparency in this area.

B.4. How can the transparency of remuneration in the sale of non-PRIPS insurance policies be improved for all participants involved in the selling of insurance products, taking into account the need for a level playing field?

We believe that the establishment of a binding principle of transparency should apply to all market participants.

B 5. Do you agree that all insurance intermediaries should have the right to be treated equally in terms of the structure of their remuneration, e.g. that brokers should be allowed to receive commissions from insurance undertakings as insurance agents?

We would support the application of principles of good practice which, when combined with greater transparency and requirements for the mandatory disclosure of both remuneration and conflicts of interest, should ensure that consumers are fully aware of how the individual selling a particular product is being rewarded.

The impact of commission on adviser behaviour is significant however. While the Panel does not have research data relating to the impact of commission based sales in the general (non-PRIPS) insurance market, the Commission will be aware that this form of remuneration is effectively being banned in the UK investment sector as a result of the FSA's Retail Distribution Review. The FSA's 2008 research into accessing investment products[2] revealed that, amongst other things, as regards adviser remuneration "This was not a subject that was well understood: everyone knew that advisers got paid, but there was confusion about how and with whose money. Furthermore there was little understanding about the true cost of advice, regardless of who was paying… and related to this, and more important, was the effect commission could have on the adviser's impartiality, and thus on the advice itself." In May 2005 BBC Radio 4's Moneybox programme[3] looked into commission bias and considered research produced by CRA International for the Association of British Insurers. The research was quoted as finding that a 0.5% rise in commission - from 5% to 5.5% - could lead to an increase in market share of 14 percentage points, from 20% to 34%.

B. 6. What conditions should apply to disclosure of information on remuneration?

In accordance with the principle of transparency we believe that it should be mandatory for information on remuneration to be provided to customers at a reasonable time before any contract is entered into. Customers should be given the opportunity to request further information if they wish.

B. 7. What types/kinds of remuneration need to be included in the information on remuneration?

All of it. No aspect of remuneration should be concealed from the customer.

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[1] Consumer decision-making in retail investment services: a behavioural economics perspective, November 2010 at http://ec.europa.eu/consumers/strategy/docs/final_report_en.pdf

[2] CR73 Accessing investment products November 2008 by Strictly Financial at www.fsa.gov.uk

[3] Article available at www.news.bbc.co.uk

Introducing clearer provisions on the scope of the IMD

"It would be appropriate to retain the activity-based definition of insurance intermediation. It is suggested that exemptions from the scope should be activity-based and not based on types of "professions" e.g. travel agents. Reinsurance intermediaries should remain within the scope of the IMD. In addition, "direct sales" by insurance undertakings and their employees could also be included. Finally, where an insurance undertaking (A) sells the products of another insurance undertaking (B), A should be considered to be the intermediary of B and subject to the provisions relating to insurance intermediaries."

Questions

C 1. In order to guarantee a real level playing field between all participants involved in the selling of insurance products, to what extent should the current IMD requirements also be applicable to direct writers and their employees? Please, specify which particular requirements should apply and reflect on the particularities of direct sales with examples (how, where, under what circumstances, etc.)

We are not in a position to comment in great detail. But overall we believe that the IMD requirements, including our suggested development of greater transparency around remuneration and managing conflicts of interest, should apply to all market participants, including product providers and their employees. We also believe that a new general principle should be introduced that advisers and sales staff act in the best interests of their clients.

C 2. A lack of clarity about the scope of the IMD could lead to unnecessary administrative burden. What are the possible clarifications that could be brought to the current scope of the IMD in this respect?

and

C 3. What conditions/reasons for exemption from IMD2 should be in place taking into account the need to ensure legal certainty and consumer protection?

The Panel is not in a position to respond to these questions.

C 4. Should a website or a person who just gives information about insurance fall under the scope of the IMD? How could the boundaries be more clearly defined in respect to insurance intermediation?

This is an important area and one where it is difficult to be definitive without providing a 'loophole' for the less scrupulous to avoid the important consumer protections set out in the IMD. We do however see no specific justification for bringing providers of general/generic information about insurance products within the IMD. It may be that the boundary lies around the provision of insurance information that relates to a specific individual.

C 5. Do you have examples of activities which, in the majority of Member States, fall under the IMD but which you believe should not be covered, such as sales of certain insurance products by car rental companies? Or conversely, do you have examples of activities which currently do not fall under the IMD but which should be covered?

Secondary sales of insurance products, such as Payment Protection Insurance sold as a result of an individual entering into a loan contract, can be a source of significant

consumer detriment. By definition the sales person is less likely to be sufficiently knowledgeable and best placed to advise about the secondary product as they are about the primary product. It is particularly important that the requirements for the disclosure of remuneration should apply to secondary sales.

C 6. Which particular requirements stemming from the Directive on the Distance Marketing of Financial Services (DMFS) need to be taken into account in IMD2? How does the definition of supplier in the DMFS Directive affect the definition of insurance intermediation?

The Panel is not in a position to respond to this question.

Increased efficiency in cross-border business

"The "single passport" under IMD is based on the principle of registration in the home Member State. It would appear appropriate to improve the legal framework in relation to the notification process and integrate the definitions on FOS and FOE into the IMD in order to render the cross border insurance intermediation process more effective. This includes a more transparent use of the general good rules. It would also appear appropriate to include the mutual recognition clause in the CEIOPS Luxembourg Protocol in the IMD."

Questions

D 1. Do you agree with the inclusion of the definition of the freedom to provide services (FOS), as laid down in the Luxembourg Protocol of CEIOPS21, in the text of the IMD?

D 2. Is there a need to further clarify the rules regarding freedom of establishment (FOE) and integrate these rules in the IMD?

D 3. How can the notification process be made more efficient and useful?

D 4. Do you agree that further rules on FOS and FOE should be included in a revised IMD in order to provide more legal certainty?

D 5. Are there any issues with regard to the general good rules in relation to the cross-border dimension of insurance intermediation? If so, please provide further details.

D 6. What problems do insurance intermediaries face today when selling cross border? How should the IMD be amended to improve the conditions for FOE/FOS activities?

D 7. Would the integration of the CEIOPS Luxembourg Protocol clause on mutual recognition in a revised IMD be useful in this respect?

D 8. Could provisions similar to those contained in the E-Commerce Directive regarding an appropriate and transparent use of general good rules be integrated into the IMD2?

The Panel is not in a position to respond in detail to questions D1 to D8. Our concern – and we believe that that this should be the objective behind any changes that will be made – is that the outcome for consumers will be a single market in which there is a minimum level of professional standards and protection, such as appropriate disclosure and access

to compensation and redress if necessary. We believe that there should be alternative dispute resolution schemes covering all sectors in all Member States, and that participation in an ADR scheme should be a pre-condition of a single passport. We hope that the new European Supervisory Authorities will play an active role in ensuring that home national regulators apply consistently high standards when authorising firms to operate under the single passport, with regular ESA reporting on standards of compliance in the EU27. As we have already indicated, we would also like to see a general principle introduced that advisers and sales staff should always act in the best interests of their clients. We would welcome too the integration of 'general good' rules into the IMD on the basis proposed.

Achieve a higher level of professional requirements

"It would appear appropriate to establish basic common principles for professional requirements for all sellers of insurance products.

In this context, one option would be to consider imposing a Member State requirement to ensure that all persons in insurance undertakings who are responsible for insurance distribution and sales in respect of insurance products, as well as all other employees directly involved in insurance or reinsurance distribution or sales, demonstrate the knowledge and ability necessary for the performance of their duties."

Questions

E 1. What high level requirements on the knowledge and ability of all participants involved in the selling of insurance products would be appropriate in view of the existing differences in the applicable qualification systems in Member States?

and

E 2. Should these requirements be adapted according to the distribution channel? If so, how?

Given the diverse nature of markets and products across Member States we think it would be appropriate to introduce a requirement that both advisers and sales staff should have a level of professional qualifications, supported by a programme of continuing professional development, that is appropriate to their role and the range of products on which they advise/sell. This should be applied on a minimum harmonisation basis to allow national regulators the flexibility to introduce more specific requirements as necessary.

Distribution of insurance PRIPS

"In the context of PRIPS, it would appear important to ensure that consistent conduct of business, inducements and conflict of interest rules are applied to all persons selling packaged retail investment products, irrespective of whether the relevant entity is an intermediary or whether it is the product originator. Detailed requirements should take into account the service being offered (advice, sales without advice). However, it is vital that market failings or risks for customers should be always be addressed in an effective or appropriate manner, irrespective of the channel through which a sale is being concluded. The rules of MiFID would appear to be the appropriate benchmark in this regard.

The person selling insurance PRIPs should be responsible for providing pre-contractual disclosure document(s) to the client. As regards direct sales, the responsibility would fall

on the product originator (PRIPS insurer). For indirect sales, the intermediary would be responsible for providing the document to the client.

In respect to the sales process and any services provided in relation to that process, the following main principles should be considered:

Insurers or insurance intermediaries selling or giving advice on insurance PRIPs should act honestly, fairly and professionally in accordance with the best interests of their clients. In the context of tied agents, the responsibility to act in the best interest of the client would remain with the insurance undertaking.

Insurance undertakings or insurance intermediaries selling PRIPs need to ensure that the client receives information as regards the remuneration of the sellers (making clear the difference between the premium paid and the actual invested part of the premium). Remuneration structures should not be such that they materially impact on the ability of the intermediary to act in the best interest of the client and should be structured in a way that effectively avoid or manage any conflicts of interest that may arise.

When providing investment advice for insurance PRIPs, the insurance intermediary or the insurer should obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, his financial situation and his investment objectives. This information should be obtained so as to enable the firm to recommend to the client or potential client the investment services and financial instruments that are suitable for that client or potential client.

Member States could be required to ensure that the insurance intermediary and the insurer, when selling insurance PRIPs without providing advice, ask the client or potential client to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or requested. This information request should enable the insurance intermediary or the insurer to assess whether the investment service or product envisaged is appropriate for the client. If the insurer or intermediary considers, on the basis of the information received, that the product or service is not appropriate to the client or potential client, the insurer or intermediary should warn the client or potential client. This warning could be provided in a standardised format.

Member States could be required to ensure that insurance intermediaries and insurers take all reasonable steps to identify conflicts of interest between themselves. This should include conflicts in relation to the intermediaries' or insurers' managers, employees and tied intermediaries, or any person directly or indirectly linked to them by control and their clients or between one client and another that arise in the course of providing any insurance, insurance intermediation and ancillary services related to PRIPs insurance policies.

Where organisational or administrative arrangements put in place by the insurance intermediary or the insurer to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to client interests will be prevented, the PRIPs intermediary and insurer could be required to clearly disclose the general nature and/or sources of conflicts of interest to the client before undertaking business on the client's behalf.”

Questions

1. What practical challenges do you think should be addressed when drafting new legislation on the distribution of insurance PRIPs?

The key objective should be a level playing field for insurance and non-insurance PRIPS and we agree that MiFID is the appropriate benchmark. This will mean having clear distinctions between and definitions of insurance based PRIPS and other insurance products, although as we have set out in this response there are general principles and requirements that should apply to all products, including those relating to disclosure of remuneration and management of conflicts of interest. The MiFID and IMD reviews will have to be closely synchronised. We would like to see a firm commitment to a post implementation review from the outset as this will be vital in ensuring that the Commission's objectives – and consumer needs – have been met.

2. What are the most important practical issues to be considered when applying the MiFID benchmark to the selling of insurance PRIPs?

It may be that the application of the MiFID benchmark to insurance PRIPS may cause significant changes to established markets and if that is the case, there will be a need to ensure that consumers are provided with sufficient information about the new sales structure before it is introduced. We are mindful too of the cost of the changes envisaged in this consultation paper, together with the possible outcomes of the MiFID review and separate paper on PRIPS. It is inevitable that at least some of the cost will be passed on to consumers and we would not wish to see some consumers effectively 'priced out of the market' as a result of these changes.

On a more detailed point, in our response to the Commission's recent paper on PRIPS we emphasised the need for pre contractual information (in the form of the Key Investor Information Document) to be produced by the product provider, not the distributor and this should apply equally to insurance based PRIPS.

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28 February 2011