

August 2012

INSURANCE MEDIATION DIRECTIVE II

Major changes ahead

Background

The Insurance Mediation Directive I ("IMD I"), which had to be implemented by all EU Members States in 2005, regulates the point of sale of insurance products. More specifically, it sets minimum standards covering matters such as fitness and propriety, training and competence, prudential requirements and complaints handling. It also requires a certain minimum of pre-sale information to be given to customers by those who sell insurance (**insurance intermediaries**).

IMD I: perceived weaknesses

A number of concerns have been raised about the ways in which IMD I has been implemented across the EU and in the context of the Solvency II debates in 2009, a specific request was made to revise it. Accordingly, on 26 November 2010, the Commission launched a consultation on possible changes to address perceived weaknesses in IMD I. The consultation period closed on 28 February 2011 and responses were published on 4 April 2011. The Commission says they showed a general consensus that changes were required to raise the level of policyholder protection across the EU.

The Commission's key concerns were as follows:

- ▶ Inconsistent implementation. The 27 Member States have implemented IMD I in substantially different ways. The Commission therefore felt some clarification was required;
- ▶ Life insurance products with an investment element. Serious concerns were raised about standards for the sale of those products, given the discrepancies between the requirements applicable to insurance products under IMD I and the much higher standards imposed on non-insurance investment products regulated by the Markets in Financial Instruments Directive (**MIFID**); and
- ▶ Limited scope. There were also concerns about the seemingly limited scope of IMD I in that, for instance, it does not apply to direct sales made by insurers.

IMD II: a tighter regime

On 3rd July 2012, the Commission presented a three-part legislative package "dedicated to rebuilding consumer trust in financial markets", which includes the proposal for the revision of IMD I (**IMD II**)¹. The final version of IMD II was published on 9th July 2012 and it makes some important changes to IMD I, some clearly aimed at addressing the perceived weaknesses mentioned above. The most significant changes are described below:

- ▶ IMD II enlarges the scope of IMD I to include direct sales by insurers, loss adjusting, and claims management activities carried out by claims management companies and insurers;
- ▶ The definition of "insurance mediation" includes certain activities carried out by insurance aggregator websites;
- ▶ The "de minimis" exclusion will only apply to insurance mediation activities ancillary to the sale of goods (e.g. opticians selling insurance on glasses) where the insurance premium received is less than €600/year (other conditions will apply);
- ▶ Insurance mediation activities that are ancillary to the sale of services (e.g. travel agents selling travel insurance) will fall within the scope of IMD II;
- ▶ A simplified declaration procedure will apply for some insurance intermediaries (e.g. travel agents as per the above, claims managers, etc) and they will be subject to a less burdensome regime;
- ▶ A new provision will allow bundling practices but not tying practices, the key difference being that when products are tied together, the insurance service or product is not available separately. IMD II will allow the bundling of insurance products with other services provided the insurance product is also available separately, even if it is then offered under different conditions or is more costly;
- ▶ A new chapter in IMD II will seek to align the requirements of IMD II and MiFID II for those selling "insurance investment products" (e.g. life insurance); and

¹ The other two items were a proposal for a regulation on transparency in Packaged Retail Investment Products (PRIIPS) and a proposal for an amendment to the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive.

- ▶ The most significant change, however, will be the new requirement for insurance intermediaries to **disclose their remuneration** to clients although there will be a transitional period for intermediaries selling non-life insurance products. This is explored in more detail below.

Other requirements, such as professional and organisational requirements (e.g. appropriate knowledge and ability, good repute) and the need to register and provide specific information prior to the insurance contract being entered into, will remain under IMD II and be subject to less significant modification. IMD II finally aims to facilitate cross-border entry for those selling insurance, and a number of provisions aim to enhance co-operation between regulators at European level, including the European Insurance and Occupational Pensions Authority.

Remuneration Disclosure

The issue of brokers' remuneration and the debate on whether commission should be disclosed is not new although it remains a lively one. The Commission had looked into this issue as early as September 2007 when it published a report on the business insurance sector enquiry (**Report**) (see our previous e-alert on the Report). The Report raised concerns over potential conflicts of interests surrounding contingent commission (payments by insurers linked to specific targets being achieved).

The Commission wanted more transparency; therefore, IMD II requires insurance intermediaries to disclose details of the ways in which they are remunerated for their advice. Remuneration is widely defined in IMD II as "*any commission, fee, charge or other payment, including an economic benefit of any kind, offered or given in connection with insurance mediation activities.*"

The disclosure requirement is stringent as it requires disclosure of the nature of the payment, the amount or basis of calculation and fairly extensive details of any contingent commission. Those requirements apply only to intermediaries. Further disclosure requirements covering variable remuneration received by employees for distributing and managing the insurance expressly apply to insurers who engage in direct sales as well as intermediaries.

The new disclosure duty will apply to those selling life insurance products as soon as IMD II is implemented. For other intermediaries there will be a transitional period of 5 years, during which they will be required to disclose some of the above only if requested by customers. Much has been written about the transitional period but its effect may be minimised given that intermediaries will also be under a duty to tell customers about their right to request information on remuneration. Moreover, the transitional period does not apply to the requirements to disclose (i) contingent commission and (ii) variable remuneration paid to employees.

What happens next?

IMD II is currently at the proposal stage and it needs to be adopted by the European Parliament and the Council before it becomes law. The European Commission hopes the legislative process will be concluded in the course of 2013, in which case **the implementation date for IMD II may be 2015**. It is difficult to say whether this forecast is realistic given current experiences concerning Solvency II. It may also be that IMD II is subject to further changes as it goes through the legislative process.

Finally, it is worth noting that IMD II is a "minimum harmonisation" legal instrument so that Member States may impose higher standards.

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