

IMD2: European Commission proposals for a revised Insurance Mediation Directive

By Julian Burling¹

Introduction

On 3 July 2012 the European Commission published² a proposal for a “recast” insurance Mediation Directive (“IMD2”) together with an accompanying Explanatory Memorandum,³ and an Impact Assessment.⁴ IMD2 is part of the new “consumer retail legislative package” which includes also information requirement proposals relating to packaged retail investment products (PRIIPS) and proposals for defining the duties and tasks of depositaries of undertakings for collective investment in transferable securities (“UCITS”) and remuneration policy for UCITS fund managers (the proposed “UCITS V” directive). This article summarises and discusses the salient features of the draft IMD2.

Insurance Mediation Directive (2002/92/EC)

The Insurance Mediation Directive (2002/92/EC) (“IMD”) was designed to co-ordinate national provisions on professional requirements and the registration of persons taking up and pursuing the activity of “insurance mediation”, so as to contribute to the completion of the single market for financial services and the enhancement of consumer protection in that field.⁵ The IMD applies to the carrying on of “insurance mediation” activities by “intermediaries” and not simply to persons who can be characterized as insurance agents or brokers. Insurance mediation activities are

“the activities of introducing, proposing or carrying out other work preparatory to the conclusion of contracts of insurance, or of concluding such contracts, or of assisting in the administration and performance of such contracts, in particular in the event of a claim”,

except where carried out by an insurance undertaking itself.⁶ Where the premium does not exceed €500 p a, the sale of travel insurance by travel agents, and the complementary sale by providers of goods or services of certain insurances such as extended warranty insurance or mobile phone insurance, are excluded from the scope of the Directive, as are (re)insurance mediation services provided in relation to risks or commitments located outside the European Economic Area (“EEA”).

The IMD requires the registration of insurance and reinsurance intermediaries by a competent authority in their home state.⁷ Such registration is to confer entitlement to provide (re)insurance mediation services throughout the EEA on a services or an establishment basis.⁸ Where an intermediary intends to provide services in another member state (the “host member state”) on either basis it must inform the competent authorities of its home member state, which must then inform the competent authorities

of any host member state wishing to know.⁹ Host member states may impose “general good” conditions applicable to business carried on in their territories.¹⁰

Article 4 of the IMD stipulates professional requirements to be imposed by member states. (Re)insurance intermediaries are to have appropriate knowledge and ability, as determined by the home member state: this requirement need not apply to every employee but is to apply to a reasonable proportion of the management of an undertaking and all persons in it who are directly involved in insurance mediation.¹¹ They are to be of good repute. They are to have professional indemnity insurance of at least €1m each and every claim and €1.5m in aggregate.¹² Member states are also to take measures for the protection of premiums and claims moneys in transmission, being either requirements that premiums received from the assured by the intermediary are treated as received by the insurer,¹³ minimum financial capacity requirements calculated by reference to 4 per cent of annual premiums received, segregated client money account requirements, or the establishment of a guarantee fund. Member states are permitted to reinforce these requirements, or add to them, as regards intermediaries registered within their jurisdiction.¹⁴ Where a member state implements a directive by applying such “super-equivalent” requirements, it is commonly described as “gold-plating” the directive.

Chapter III of the current IMD specifies requirements as to information to be provided by intermediaries to their customers, except when the intermediary mediates in the insurance of “large risks”¹⁵ or in reinsurance. This must include disclosure as to holdings by the intermediary in any insurance undertaking or vice versa. It is also to include a statement whether the intermediary gives advice based on a fair analysis of a sufficiently large number of contracts available in the market to enable him to make a recommendation regarding which contract would be adequate to meet the customer’s needs. Alternatively the intermediary may be under a contractual obligation to conduct insurance mediation exclusively with one or more undertakings, or is not under such a contractual obligation but nevertheless does not conduct a fair analysis of a large number of contracts available on the market.¹⁶ Member states may impose stricter requirements.¹⁷ Insurance intermediaries are also to be required to provide a “demands and needs statement” to the customer, on the basis of information provided by the customer, stating the underlying reasons for advice given on a specific insurance contract.¹⁸

Member states were required to implement the IMD before 15 January 2005. In the UK the IMD was transposed principally by means of the Financial Services and Markets Act 2000 (Regulated Activities)(Amendment)(No.2) Order 2003, SI 2003/1476. It specified various activities in relation to “relevant investments” (ie insurance contracts, both life and non-life) as “regulated activities” for the purpose of the Financial Services and Markets Act 2000 (“FSMA”). This necessitated the authorisation of non-life insurance intermediaries by the Financial Services Authority under FSMA from early 2005: most life insurance salesmen were already covered by other delegated legislation under that Act¹⁹.

The FSA made the “Insurance: Conduct of Insurance Business Sourcebook” (“ICOB”), implementing the customer information provisions in IMD with much “guidance”, and subsequently the stripped-down “Insurance: New of Insurance Business Sourcebook” (“ICOBS”). ICOB and ICOBS also transposed in part the Distance Selling of Financial Services Directive (2002/65/EC) and the E-Commerce Directive (2003/31/EC). ICOB and ICOBS applied to activities in relation to “non-investment insurance contracts” (except reinsurance or large risks outside the EEA or large risks within the EEA mediated for commercial customers). Those activities include not only “insurance mediation activities” but also the carrying on by insurers of insurance business, the management of Lloyd’s syndicates and the communication or approval of financial promotions. Direct selling and claims handling by insurers were thus included in the “insurance mediation regime” so far as the UK was concerned.

In the absence of such provision in the IMD itself, the Luxembourg Protocol²⁰ provides a framework for co-operation between the competent authorities of the EEA member states in the implementation of the IMD and the carrying out of their functions under it.

Reform

The IMD was a minimum harmonisation instrument, containing high-level principles. Its implementation across the EU varied considerably between countries, with much gold-plating in some countries and minimalist, more literal “copy-out” in others. This inhibited the development of a single insurance market. Implementation checks by the European Commission between 2005 and 2008 revealed a need to review it.

Recital (139) of the Solvency II Framework Directive (2009/138/EC) (“Solvency II”) required the European Commission to put forward by the end of 2010 a proposal for the revision of the IMD, given that Solvency II “changes the risk profile of the insurance company vis-à-vis the policy holder”. Some members of the European Parliament had considered that there was a need for improved consumer protection in the wake of the financial crisis, particularly as regards investment-type life insurance. To ensure cross-sectoral consistency the European Parliament requested that any review of the IMD should take into account the ongoing revision of the Market in Financial Instruments Directive (“MiFid II”).²¹ The Commission, after obtaining initial advice from the Committee of European Insurance and Occupational Pensions Supervisors (“CEIOPS”),²² issued a consultation document²³ on 26 November 2010.

That consultation document identified the following main weaknesses in the current IMD:

- the insufficient quality of information given to consumers (varying significantly between member states);
- ineffective rules in Article 12 on conflicts of interest, and the absence of any rules at all as to transparency on remuneration;

- legal uncertainty resulting from the definition of the scope of IMD and, even more importantly, the lack of a level playing field between all concerned in selling insurance products given the exclusion of direct selling by insurance companies; and
- the burdensome notification system for cross-border establishment or services, limiting the market for cross-border retail insurance.

The consultation document sought comment on various proposals designed to address these shortcomings. It proposed in addition a higher level of professional requirements as to knowledge and ability for all sellers of insurance products. In the context of insurance PRIPS (investments packaged as life insurance products, such as unit-linked life policies) the consultation document urged the importance of consistent conduct of business rules, inducements and conflict of interest rules applicable to all persons selling packaged investment products, whether product originator or intermediary.

The consultation period for the November 2010 document closed on 31 January 2011. 125 responses were received to the public consultation, generally in favour of a revision of the IMD.²⁴

IMD2

Eighteen months after the end of the consultation period, and following various public meetings, and four studies commissioned as part of an impact assessment,²⁵ the European Commission has now published a draft revised IMD, a revision in some respects considerably more ambitious than its November 2010 consultation document might have suggested. The Explanatory Memorandum states that the proposal is to be seen in the light of draft G20 high level guidelines on financial consumer protection: G20 had in November 2010 requested the OECD, FSB and other international organisations to develop common principles in the financial field to strengthen consumer protection.

The Explanatory Memorandum states that IMD2 will replace (“recast”) the current IMD as a new directive (although it takes the form of amendments grafted onto the existing legislation). Like the current IMD, IMD2 will be a “level 1” framework directive. Although IMD2 will continue to have the features of a “minimum harmonization” legal instrument, some parts of it will be reinforced by more detailed rules to be adopted under delegated powers at “level 2”. These measures should align the rules with MiFID. The European Insurance and Occupational Pensions authority (“EIOPA”), which has replaced CEIOPS, is to play a role in implementing the framework, with specific competences to be given to it. The Commission envisages such a role for itself as well.²⁶

Scope: undertakings and activities

The scope of the Directive is to be extended to include all sales of insurance products, so that it will apply to insurance undertakings selling insurance directly (and to their sales,

after-sales and claims processes).²⁷ To ensure the same level of consumer protection regardless of the distribution channel, it will include other market participants who sell insurance products on an ancillary basis, such as travel agents and car rental companies, and also suppliers of goods who do not meet the conditions for one of the exemptions²⁸ (the annual premium limit for the exemption being raised to €600).²⁹ IMD2 will also extend, as regards the activity of assisting in the performance of contracts, to professional claims managers and loss adjusters.³⁰

“Insurance mediation” is redefined as including also largely the same activities as within the current IMD definition even when carried on by an insurance undertaking without the intervention of an intermediary.³¹ It no longer includes “introducing” but now includes advising³² on the conclusion of insurance contracts,³³ otherwise than on an incidental basis.³⁴ It now includes, somewhat elliptically,³⁵ operating an aggregator website or similar facility when the customer is able to conclude an insurance contract at the end of the process, notwithstanding that the aggregator operator is not normally an agent to conclude contracts. “Customer”, however, is not defined and the question of intermediary chains is not addressed anywhere in IMD2.

Registration

The registration procedure under Article 3 for intermediaries is substantially unchanged.³⁶ Member states will now be required by Art 3(2) to establish online registration systems. EIOPA is to establish on its website a single register containing records of all intermediaries that have notified their intention to carry on cross-border business. This will act as a portal linking back to the home state registers. Member states are to ensure that competent authorities monitor continuing compliance with registration requirements.³⁷ They are to require, as a condition of registration, information about shareholders in intermediaries having holdings in excess of 10 per cent or persons having close links with them.³⁸

A new Article 4 provides a simple “declaration” procedure for intermediaries conducting insurance mediation only on an ancillary basis as regards certain classes of business, or conducting full time claims management or loss adjustment or assessment. Such intermediaries will simply inform the home state competent authority and comply on a continuing basis with specified requirements of the Directive.

Freedom of Services and Establishment

Articles 5 and 6 reflect the provisions in Articles 6 and 7 of the current IMD as regards freedom to provide services and freedom of establishment. The home state competent authority is now to obtain and provide to the proposed host state competent authority specified information about the intermediary. This should include, in the case of proposed exercise of a right of establishment, a programme of operations and the identities of any

agents to be used. The new Article 7 provides for the division of competence between the competent authorities of home and host member states. If the intermediary's primary place of business is in a different member state from that of its home state the competent authorities will be able to agree that the competent authority of the host state is to be able to act as if it were the home state competent authority with regard to the obligations in IMD2 Chapter VI (information requirements and conduct of business rules) and the new Chapters VII (PRIPS) and VIII (sanctions and measures).

A new Article 9 requires the publication by each member state of any "general good" rules applying to (re)insurance mediation. Any administrative burden on those carrying out (re)insurance mediation activities that stems from requirements beyond those in the Directive is to be restricted to what is proportionate for consumer protection. Details of "general good" rules are to be provided by the competent authorities in each member state to EIOPA, which is to publish them on its website in English, French and German. EIOPA is to examine, and inform the Commission about, the effect of "general good" rules in the context of the proper functioning of IMD2 and the Internal Market within three years after IMD2 comes into force. These provisions are designed to meet the problems resulting from fragmentary implementation and gold-plating of the current IMD.

Professional and organisational requirements

The new Article 8, in place of IMD Article 4, provides for professional and organisational requirements which are largely unchanged (including those as regards protection of insurance moneys in transmission). There is a new focus on development of staff knowledge and ability. EIOPA is to review professional indemnity insurance and financial capacity levels every five years, and to develop draft regulatory technical standards for the purpose.³⁹ The European Commission is to be empowered to adopt "delegated acts" specifying the requisite content and level of knowledge and ability of intermediaries, appropriate criteria for determining the level of professional qualifications, and continuing professional development.⁴⁰

Information requirements and conduct of business rules

IMD2 Article 15, commendably, lays down some general principles. Member states are to require that insurance intermediaries or undertakings carrying out insurance mediation "with or for customers" are to act "honestly, fairly and professionally in accordance with the best interests of their customers".⁴¹ As between principals who are simply counterparties to a contract of insurance, rather than as between principal and agent, this "best interests" requirement seems unduly demanding: where there is no fiduciary relationship such as that between principal and agent, contracting parties might each normally be expected to have primary regard to their own interests. All information addressed by intermediaries or insurers to customers or potential customers is, familiarly, to be fair, clear and not misleading.⁴²

Member states are to require that before entering into an insurance contract an intermediary is to disclose to its customer, inter alia, whether it provides advice about the products sold, whether it is representing the customer or acting on behalf of the insurer.⁴³ Similarly, an insurer is to state whether it provides any type of advice about products sold,⁴⁴ but it has already been noted that “advice” merely means providing a recommendation. As before, intermediaries are to provide customers with information about shareholding links with insurers,⁴⁵ and whether it gives advice on the basis of a fair analysis.⁴⁶

The Commission has now in IMD2, Article 17, grasped the nettle of mandatory disclosure of brokers’ remuneration, about which the FSA has to date been more reticent.⁴⁷ For some lines of business, particularly consumer business, the remuneration received by the intermediary can exceed the net premium received by the insurer. Prior to the conclusion of the insurance contract the intermediary is to disclose to the customer the nature of the remuneration received in relation to the contract. The disclosure is to state whether remuneration in relation to the contract is on the basis of a fee paid by the customer, or on the basis of a commission of any kind “that is the remuneration included in the insurance premium”, or on the basis of a combination of both. If a commission or fee is being received the full amount concerning the insurance products being offered or considered is to be disclosed, or, if the precise amount is not capable of being given, the basis of calculation is to be disclosed. If the amount of commission is to be based on targets or thresholds agreed with the insurer, ie contingent commission, the intermediary is to disclose the targets or thresholds as well as the amounts payable.⁴⁸ The new requirements do not, however, address “work transfer” payments frequently made by insurers to brokers (ie agents of the insured) for specific policy administration activities that become the responsibility of the broker. These can be substantial amounts for what is sometimes an automated activity.

For an initial period of five years disclosure of intermediaries’ remuneration in relation to non-life business will be on request only, but the customer must be informed of his right to request it.⁴⁹ The distinction is justified in the Explanatory Memorandum to the Commission’s IMD2 proposal⁵⁰ on the basis that commissions on non-life products tend to be much lower and that it is easier to change to another non-life product. In feedback to the November 2010 consultation there had been some opposition to the remuneration disclosure proposals on the ground that the consequent lowering of commissions “could result in lower quality of advice, could encourage mis-buying, could provoke diversion from the issues of coverage, conditions and price and a shift to cheaper internet non-advised sales”.

The Directive is to be reviewed five years after entry into force.⁵¹ Member states can adopt stricter provisions but must notify EIOPA and the commission if they do so.⁵²

With a view to ensuring a level playing field, the insurance undertaking or intermediary is also to be required to inform the customer about the nature and basis of calculation of any variable remuneration received by any employee for distributing and managing the insurance product.⁵³

The Commission is to be empowered to specify criteria for determining (a) how intermediary remuneration, including contingent commission, is to be disclosed, (b) appropriate criteria for determining the basis of calculation of fees and commissions (an exercise likely to be strenuously resisted by market participants), and (c) the steps that intermediaries and insurers might reasonably be expected to take to disclose their remuneration.⁵⁴

The new disclosure obligations discussed above and the current requirement for a statement of demands and needs and reasons for advice are not to apply where the mediation is of a large risk or reinsurance or where the customer is a “professional customer”, as specified in the Annex: ie one who possesses the experience, knowledge and expertise to make his own decisions and properly assess his risks. Under English common law professional customers would nevertheless be entitled to disclosure on request.

Cross-selling

IMD2 Article 21 contains succinct new rules permitting member states to allow bundling practices but not tying practices. The former permit the insurance product to be purchased separately from the ancillary service or product but the latter do not.⁵⁵ The customer is to be informed of his right to purchase the bundled products separately and of the costs and charges of each component. EIOPA is to develop guidelines for the assessment and supervision of cross-selling practices.⁵⁶ Maybe not entirely coincidentally, following the implementation of its Banking Conduct Regime, the FSA has recently published proposals for regulating the selling of packaged bank accounts, including insurance products.⁵⁷

Insurance investment products

Chapter VII of IMD2 contains additional requirements to be imposed on insurance intermediaries or undertakings selling “insurance investment products”, which are to be defined by reference to the proposed PRIIPS Regulation.⁵⁸ The Commission will be given power by “delegated act” to define steps that may be required to identify and prevent or manage conflicts of interest and to establish criteria for specifying types of conflicts that might damage the interests of customers. Article 24, based on MiFID II, stipulates that member states require insurance intermediaries and undertakings to act honestly and professionally in the best interests of customers and provide information that is fair clear and not misleading, and to provide specified types of information.

Sanctions

Sanctions have not been harmonised in EU financial services legislation. The current IMD required that member states provide for appropriate sanctions but did not specify what they should be.⁵⁹ The Impact Assessment accompanying the draft IMD2, although not the

November 2010 Commission consultation document, discerned that the enforcement system was not working. Some national authorities lacked powers; others did not enforce the rules. Surveys indicated that a majority of consumers felt powerless in relation to insurance providers.⁶⁰ A new Chapter VIII in IMD2 requires member states to provide effective, proportionate and dissuasive administrative sanctions and measures. These are to include “administrative pecuniary sanctions” for breaches of registration requirements, professional and organisational requirements and conduct of business rules. Member states are to ensure that the competent authorities have all necessary investigatory powers and to co-operate on cross-border cases.

Conclusion

The European Commission press release “frequently asked questions” assume that adoption of IMD2 by the European Parliament and Council is likely to happen during 2013, with work on the technical measures shortly thereafter and entry into force likely in 2015. Although a full “Lamfalussy structure”⁶¹ has not been adopted, the draft IMD2 would confer significant delegated authority on the Commission, which may meet some resistance. Whatever may be the internal EU politics, IMD2 will in many respects give significant enhancement of protection for potential policyholders.

Endnotes

¹ A barrister practising at Serle Court chambers.

² See http://ec.europa.eu/internal_market/insurance/consumer/mediation/index_en.htm

³ http://ec.europa.eu/internal_market/insurance/docs/consumers/mediation/20120703-directive_en.pdf, . Draft Directive and Explanatory Memorandum.

⁴ http://ec.europa.eu/internal_market/insurance/docs/consumers/mediation/20120703-impact-assessment_en.pdf

⁵ IMD, recital (8)

⁶ IMD, Art. 2(3)

⁷ IMD, Art. 3(1)

⁸ IMD, Art. 3(5)

⁹ IMD, Art. 6(1)

³ IMD, Art 6(3)

¹¹ IMD, Art 4(1)

¹² IMD, Art 4(3)

¹³ Called “risk transfer” in the UK.

¹⁴ IMD, Art 4(6)

- ¹⁵ As defined in Article 5(d) of Directive 73/239/EEC: broadly, MAT, credit and surety, and other large commercial risks.
- ¹⁶ IMD, Art 12(1)
- ¹⁷ IMD, Art 12(5)
- ¹⁸ IMD, Art 12(3)
- ¹⁹ COB and latterly COBS, implementing MiFID (2004/39/EC)
- ²⁰ https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/protocols/Luxembourg_Protocol%20without%20annexes_Rev1_Oct2008.pdf
- ²¹ See Explanatory Memorandum, p2.
- ²² http://ec.europa.eu/internal_market/insurance/docs/mediation/advice-ceiops-imd2_en.pdf; https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/submissionstotheec/20101111-CEIOPS-Advice-on-IMD-Revision.pdf
- ²³ http://ec.europa.eu/internal_market/consultations/docs/2010/insurance-mediation/consultation-document_en.pdf
- ²⁴ For a summary of responses, see http://ec.europa.eu/internal_market/consultations/docs/2010/insurance-mediation/summary_of_responses_en.pdf
- ²⁵ See Explanatory Memorandum, p4.
- ²⁶ *Ibid*, p6.
- ²⁷ IMD2, recital (5).
- ²⁸ IMD2, recital (6).
- ²⁹ IMD, Art 1(2)(f)
- ³⁰ IMD2, recital (7), Art (1).
- ³¹ IMD2, Art 2(3).
- ³² “Advice” is now to be defined in Art 2(9) as the provision of a recommendation to a customer whether at their request or on the initiative of the insurance undertaking or intermediary.
- ³³ *Ibid*.
- ³⁴ IMD2, Art 2(3)(a)
- ³⁵ IMD2, recital (12)
- ³⁶ Insurance undertakings registered as such under the Insurance Directives will not be required to register under IMD2.
- ³⁷ IMD2, Art 3(6)
- ³⁸ IMD2, Art 3(7)
- ³⁹ There seems to be some confusion in the draft as to whether these are to be regulatory technical standards or implementing technical standards: presumably they are to be the former.

For the distinction see “The path to Solvency II implementation – rocks and hard places”, BILA Journal 123 (November 2011) page 13, by Chris Finney

⁴⁰ IMD2, Art 8(8).

⁴¹ IMD2, Art 15(1)

⁴² IMD2, Art 15(2)

⁴³ IMD2, Art 16(1)(a)

⁴⁴ IMD2, Art 16(1)(b)

⁴⁵ IMD2, Art 17(1)(a), (b)

⁴⁶ IMD2, Art 17(1)(c)

⁴⁷ As regards consumers, the FSA has made no requirements for mandatory disclosure of commissions paid by insurers, concluding from surveys that they are not generally influenced by such matters but rather by absolute price : FSA “ICOB Review Interim Report” 2007, section 5.1, http://www.fsa.gov.uk/pubs/other/icob_review.pdf. As regards commercial customers there is a requirement to disclose, on request only, remuneration paid by insurers. Trade bodies have been left to develop guidance for their members: FSA FS08/7

⁴⁸ IMD2, Art 17(1)(e)-(g)

⁴⁹ IMD2, Art 17(2)

⁵⁰ at p10.

⁵¹ IMD2, Art 35

⁵² IMD2, Art 19(1)

⁵³ IMD2, Art 17(3)

⁵⁴ IMD2, Art 17(5)

⁵⁵ IMD2, Art 2(19), (20)

⁵⁶ IMD2, Art 21(3)

⁵⁷ CP11/20, CP12/17

⁵⁸ IMD2, Art 2(4)

⁵⁹ IMD, Art 7.

⁶⁰ Impact Assessment, pp18-19.

⁶¹ See http://ec.europa.eu/internal_market/securities/lamfalussy/index_en.htm

