

Consumer protection in EU insurance sector: towards a regulation overdose?

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BACKFIRING ON THE LATEST E.U. REGULATION PROPOSAL

Have European institutions gone too far in regulating consumer protection in insurance services? One may wonder so, especially in light of the news that recently shook the insurance industry. On September 1st, the European Parliament's Economic and Monetary Affairs Committee rejected the Regulatory Technical Standards (RTS) component of PRIIPs regulation, which had triggered strong reactions from several European countries including the UK, Germany and France, as well as from the powerful industry lobby. That was a first for the European Parliament, which had never rejected any technical standards proposed by the EU Commission before. Since then, the European commission has officially decided on November, an extension to the date of application of the PRIIPs regulation, by one year to 1 January 2018. This deferral appears to be the result of many requests following concerns raised by the contents of the Key information document (KID) and the possibility of having the PRIIPS regulation enters into force without RTS. This extension aims at solving uncertainty ensued from the situation while providing additional time to prepare for KID compliance.

As from now, the Commission has to work closely with the European Supervisory authorities (ESMA, EIOPA and EBA) which are required to submit revised RTS to the Commission within six weeks. The revised RTS will then need for Parliament and Council approval.

This outcry points out what is currently at stake within the insurance sector facing large inflation of rules. What will be the reaction regarding the implementation of the new Insurance Distribution Directive (EU 2016/97)? Is a similar crisis about to happen?

The EU regulation on Packaged Retail and Insurance-Based Investment Products (PRIIPs) (EU 1286/2014) aims to standardise pre-contractual information for non-professional investors through a standardised Key Information Document (KID) of up to three pages. Its purpose is to facilitate comparisons between different types of insurance products before making an investment decision.

This regulation is applicable to all investment funds and insurance products whose value is exposed to market fluctuations, with the exception of pension products, hence making European life insurers first in line to start issuing KID.

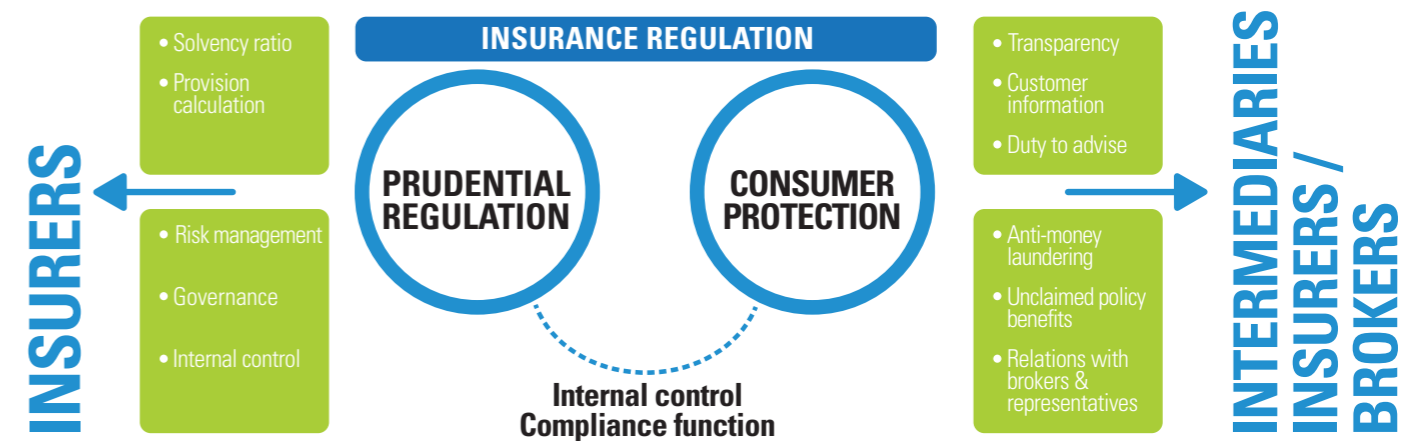
AN INSURANCE REGULATORY SYSTEM BASED ON TWO MAIN THEMES

The EU insurance regulatory framework essentially revolves around two main axes:

- Prudential regulation, including solvency and risk management measures;
- Consumer protection regulation, including a mandatory framework for business practices.

These two pillars of insurance regulation are greatly interrelated; hence increasingly driving insurance companies towards an optimised management of their legal burden, through process improving, further exchange of information and more cooperation between operational actors. Regulatory changes now have impacts on all industry players alike, insurers, bank-insurers, intermediaries and brokers alike.

More than ever, the Compliance Function and Internal Control shall play a decisive role within this constraining framework, by sharing valuable insight on all issues and risks related to prudential and consumer protection regulations. Indeed, Internal Control follows a risk management approach, while the Compliance Function ensures a permanent monitoring on all standards and regulations to which the company must abide.



SUPERVISING AND MONITORING INSURANCE INTERMEDIARIES

The insurance industry relies on a large number of intermediaries, be it insurance distribution or insurance management. This situation raises a major issue regarding the sharing of responsibilities. Current regulation imposes strict rules on insurers, including requirements to formalise agreements as well as continuous monitoring of delegated activities.

Insurance companies shall be able to justify their compliance with consumer protection regulation at any time, inclusive of all delegated activities. Subsequently, regulators expect insurers to implement processes that are both precise and constraining enough to ensure regular reporting and controlling of information from intermediaries.

AN INCREASINGLY COMPLEX LEGAL ENVIRONMENT

1- Navigating through an ever dense legal corpus

Recent regulation such as PRIIPs and the Insurance Distribution Directive (EU 2016/97) come on top of already-existing laws pertaining to consumer protection. For instance, insurers were already subject to a duty to advise prior to the latest regulatory wave. In fact, the European insurance industry copes with requirements on a wide range of issues that are often revamped

throughout successive EU Directives, European Commission Regulations and EIOPA guidelines. This tendency has kept growing, to the extent that it is now a concern for most industry players which are currently overwhelmed by the piling up of regulations in their already heavily regulated sector.

2- Working with a soft law

National insurance regulatory authorities are entitled to put together their own guidelines, consisting of clarifications of EU regulations as well as additional guidance inspired from best practices. As a matter of fact, national authorities do commonly use this ability, just like they have done with Solvency II. However, so far these regulations seem to fall short of providing a flexible and non-restrictive legal framework based on principles rather than strict rules. Instead, they have led to more obligations for insurers, who could face sanctions in case of non-compliance.

There are three main types of sanction measures by regulatory authorities:

- Administrative enforcement measures: they typically take the form of warnings, for example in case of a practice that could affect consumers' interests; there are also cease and desist orders, for instance when an insurer does not comply with an obligation and is compelled by the authority to take corrective measures within an imposed deadline.
- Disciplinary sanctions: such as formal warnings, accreditation withdrawals or

financial penalties, more or less severe depending on the seriousness of the negligence.

- Other measures: such as public disclosure of any information the authority deems necessary to fulfil its mission, publication of sanctions with or without naming the company and modification or removal of any document that breaches legislative or regulatory requirements for life insurance products.

For example, the French national regulatory authority monitors consumer protection compliance through the following areas:

- Business practices of insurers as well as intermediaries;
- Response to customers' requests and customer claim management;
- Advertising, contracts, products and services;
- Approval of companies' codes of conduct and/or moral codes.

A NEW DIRECTIVE: WHAT TO EXPECT?

The Insurance Distribution Directive (IDD) that came into force on 20 January 2016 sets out a specific framework for regulating insurance brokers, agents and intermediaries in the EU. It introduces significant new requirements regarding consumer protection and adds new principles that may lead to structural changes within the organisation of intermediaries and insurers themselves.

The IDD targets minimum harmonisation and may therefore not prevent EU Member States from adding extra requirements during its implementation. Member States have to transpose the IDD into national laws before 23 February 2018, but States like

France have expressed its will to complete transposition before that deadline.

The Directive (EU) 2016/97 is intended to deeply change insurance distribution standards, by improving customer protection and compelling insurance product issuers to make their practices and organization evolve throughout products' lifecycle.

The main innovation of the IDD Directive is the extension of its scope: indeed, it is not only applicable to insurers but also to intermediaries and all other sellers of insurance products, including occasional ones such as travel agents.

Main features of the new regulation

Strengthening of pre-contractual information requirements	<ul style="list-style-type: none"> • Customers should be provided with clear information about contracts before purchase, regardless of whether they buy from an intermediary or directly from an insurer. • Information is presented in a standardised Product Information Document (PID). • Operational consequences: companies have to combine these new requirements with existing European regulations and adapt their practices to all new contractual documentation.
Product oversight and governance requirements	<ul style="list-style-type: none"> • Insurance producers and distributors have to implement permanent product monitoring processes in order to ensure that all products meet consumers' interests and needs. • Operational consequences: industry players must re-define existing product approval procedures and strengthen the role of their Compliance Function.
Prevention of conflicts of interest and remuneration transparency	<ul style="list-style-type: none"> • Customers must receive accurate and relevant information regarding the insurer's remuneration on the contract before its sale, including non-financial remuneration, in order to prevent any sale that does not serve customers' interest. • Operational consequences: insurers need to accurately assess potential impact on their business model, profitability and products, as well as to estimate the cost of compliance.
Continuous professional training	<ul style="list-style-type: none"> • Employees of insurance companies and intermediaries will be required to receive professional training for at least 15 hours a year. • Operational consequences: companies will need to match individual trainings with the types of product sold, the type of distributor, as well as the specific role and tasks of every employee.

Even though EU Member States seem to have been given some autonomy to transpose the IDD, an announced further Delegated Regulation by the European Commission will most likely add more rules to this first set.

EIOPA's preparatory work

Following its preparatory guidelines on governance and product oversight by insurers and distributors of insurance products, EIOPA initiated preparatory technical works on the sensitive issue of the transposition of the EU directive. The Authority was asked by the European Commission to clarify some of the requirements underlying Directive 2016/97, including product oversight and governance (Article 25), conflicts of interest (Articles 27 & 28), inducements (Article 29) and assessment of suitability and appropriateness and reporting to customers (Article 30). EIOPA submitted its draft technical standards in July for a public consultation, which ended on October

3rd. The objective of the consultation was threefold:

- Ensuring insurance products meet consumers' needs and prevent mis-selling of products, throughout their lifecycle;
- Ensuring payments made to third parties, such as commissions, does not negatively affect the quality of services to the customers;
- Ensuring that insurance companies and intermediaries sell appropriate products to individual customers.

Inputs gathered from the consultation are being used by EIOPA to complete its final report to the European Commission, which is due on February 1st, 2017 the latest. Later on, the Authority may consider issuing level 3 guidance to guarantee appropriate enforcement of both the insurance distribution Directive and its corresponding Delegated Regulation.

CONCLUSION

Current consumer protection processes of most insurance industry players in Europe are highly inadequate regarding the new incoming regulatory requirements. There is hence considerable compliance work ahead for the industry. Processes and systems should be revised in order to take into account consumers' interest. With this reform, the EU has clearly stated its intention to put consumers at the heart of insurance business.

Insurance professionals are rightly worried about the growing consumer protection-related legal corpus, especially bearing in mind the Solvency II precedent, which had introduced numerous changes compared with the previous regulatory regime.

Insurers should therefore keep an attentive eye on both EIOPA's works as well as national transposition works. Above all, they must prepare for their operational impacts to come.

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