



EUROPEAN COMMISSION

Strasbourg, 3.7.2012
SWD(2012) 191 final

COMMISSION STAFF WORKING DOCUMENT

IMPACT ASSESSMENT

Accompanying the document

Proposal for a Directive of the European Parliament and of the Council

on Insurance Mediation

{COM(2012) 360 final}

{SWD(2012) 192 final}

TABLE OF CONTENTS

COMMISSION STAFF WORKING DOCUMENT	4
1. General	5
1.1. Overview of preparatory work	5
1.2. Procedural issues	6
1.3. External expertise and consultation of interested parties	6
2. Policy context.....	9
2.1. Legislative framework	9
2.1.1. Legal situation before IMD1	9
2.1.2. IMD1 – its scope, purpose, main provisions and implementation.....	9
2.1.3. Other relevant EU legislation and ongoing policy initiatives	11
2.2. Structure of the insurance distribution markets in the EU	12
2.2.1. Market size	12
2.2.2. Insurance products	12
2.2.3. Market operators and distribution channels (Annex 8).....	13
2.2.4. Role of SMEs in the insurance markets	14
3. Identification of problems	15
3.1. General problems related to IMD 1 on both insurance and insurance PRIPs products.....	15
3.1.1. Narrow scope	16
3.1.1.1. Which sellers of insurance fall outside the scope of IMD1?	16
3.1.1.2. Which buyers of insurance fall outside the scope of IMD1?.....	17
3.1.2. Conflicts of interest.....	18
3.1.3. Advice and professional qualifications	19
3.1.4. Cross-border business	20
3.1.5. Sanctions in insurance distribution	21
3.2. Problems relating to Packaged Retail Investment Products (PRIPs).....	22
4. Subsidiarity	23
4.1. How would the problem evolve without EU action? The base line scenario	23
4.2. The EU's right to act.....	23

5.	Objectives.....	23
5.1.	Consistency of the objectives with other EU policies.....	23
5.2.	Consistency of the objectives with fundamental rights.....	23
6.	Policy Options.....	23
6.1.	Proposed legislative structure of IMD2 and involvement of EIOPA	23
6.2.	Identification of options	23
7.	Analysis of Impacts and Comparing the Options	23
7.1.	Extension of the scope	23
7.2.	Conflicts of interests	23
7.3.	Advice	23
7.4.	Cross-border business	23
7.5.	Sanctions	23
8.	Analysis of the impacts	23
8.1.	Overall impacts of the package.....	23
8.2.	General expected impact of revised IMD on market structure	23
8.3.	IMD2 proposed rules and their proportionate application to SMEs	23
8.3.1.	Are the preferred policy options proportionate for smaller market players selling insurance products?.....	23
8.3.2.	Impact on SME intermediaries selling insurance as their main activity (approx. 700 000 entities) - A and B categories.....	23
8.3.3.	Impact on SME intermediaries selling insurance as an ancillary activity (approx. 80 000 entities) - C and D categories.....	23
8.4.	Employment and social impact.....	23
8.5.	Administrative cost and administrative burden.....	23
8.6.	Overview of costs on the basis of the preferred options in million EUR	23
8.7.	Estimation of benefits	23
8.7.1.	Quantitative approach to the calculation of the benefits.....	23
8.7.2.	Qualitative approach to the calculation of the benefits.....	23
8.7.3.	Improved choice of insurance products for consumers.....	23
8.7.3.1.	Greater business opportunities for sellers of insurance products.....	23
8.7.3.2.	Reduced costs for sellers of insurance products	23
9.	Monitoring and evaluation	23

COMMISSION STAFF WORKING DOCUMENT

IMPACT ASSESSMENT

Accompanying the document

Proposal for a Directive of the European Parliament and of the Council on Insurance Mediation

COMMISSION STAFF WORKING DOCUMENT

Accompanying the document

Directive of the European Parliament and of the Council on Insurance Mediation

Introduction

The Directive 2002/92/EC of the European Parliament and the Council on insurance mediation (IMD1) is the EU legislation which regulates the point of sale of insurance products¹ for the protection of policyholders. It was adopted on 9 December 2002 and had to be transposed by Member States by 15 January 2005. The Directive is a minimum harmonisation instrument containing high level principles and has been implemented in the 27 Member States in substantially different ways. The need to review IMD1 already became apparent during the implementation check carried out by the Commission in 2005-2008.

Current and recent financial turbulence² has underlined the importance of ensuring effective consumer protection across all financial sectors. In November 2010, the G20 asked the Organisation for Economic Co-operation and Development (OECD), the Financial Stability Board (FSB) and other relevant international organisations to develop common principles in the field of financial services in order to strengthen consumer protection. The draft G20 high level principles on financial consumer protection underline the need for proper regulation and/or supervision of all financial services providers and agents that deal directly with consumers. They stipulate that consumers should always benefit from comparable standards of consumer protection.

Supervisors (through CEIOPS now EIOPA) have also contributed to the common and uniform day-to-day implementation of IMD1 and in particular to its consistent application by national supervisory authorities. The adoption of the Luxembourg Protocol in 2006³ provides

¹ A detailed description of insurance distribution markets can be found in Chapter 2 and Annex 2.

² Information about the impact of the financial crisis on the insurance sector can be found in Annex 7.

³ Protocol Relating to the Cooperation of the Competent Authorities of the Member States of the European Union in Particular Concerning the Application of Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on Insurance Mediation.

https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/protocols/Luxembourg_Protocol%20_without%20an nexes_Rev1_Oct2008.pdf

a framework for cooperation between competent authorities with regard to the implementation of IMD1.⁴ Despite this Protocol, in 2007 CEIOPS advised the Commission to amend IMD1 in order to provide legal certainty.

During the discussions in the European Parliament on the Solvency II Directive which introduces a risk-based approach in the supervision of insurance undertakings and makes supervision more efficient, a specific request was made to review IMD1. Some Members of the Parliament and some consumer organisations considered that there was a need for improved policyholder protection in the aftermath of the financial crisis and that selling practices for different insurance products, particularly life insurance products with investment elements (e.g. unit-linked contracts), could be improved.

In revising IMD1 to ensure cross-sectoral consistency, a request was made by consumer groups to take into account the ongoing revision of the Markets in Financial Instruments Directive (MiFID). Whenever the selling practices of life insurance products with investment element were to be specifically regulated, the proposed IMD2 should meet at least similar consumer protection standards to those in MiFID.

There were indications of potential market failure in respect of insurance brokerage in the Commission Communication on the Sector Inquiry on business insurance.⁵ It concluded that the Commission intended to look at these issues in the framework of the review of the Insurance Mediation Directive.

This impact assessment evaluates the major policy choices relating to a revision of the rule on selling practices in IMD1 as well as their possible impact. The aim of the current revision of the IMD is to achieve a recast single market and consumer protection directive. There are two high level objectives in the new provisions: better consumer protection; and easier trading across borders.

1. GENERAL

1.1. Overview of preparatory work

Table 1

Major steps / inputs	Timing
CEIOPS Report on the Implementation of IMD	May 2007
DG Competition sector inquiry in business insurance	September 2007
EP request (Solvency II Framework Directive)	December 2009
Launch of Call for Advice	January 2010
EIOPA advice	November 2010
Public Consultation	November 2010
Public Hearing	December 2010
Publication of the results of the public consultation	April 2011

⁴ The Protocol sets out the general aims and principles for the cooperation between competent authorities regarding mainly the registration procedure, the supervision of professional requirements and professional secrecy. It also covers the registration and notification procedures, including the minimum information to be contained in the public registers and to be given in a notification for cross-border mediation services. It provides details on the procedures of exchange of information and on going supervision of intermediaries and covers some general matters regarding out-of-court settlements of complaints.

⁵ Under Article 17 of Regulation (EC) No 1/2003, published in September 2007.

1.2. Procedural issues

The impact assessment work started in 2010.

The IA Board met on 23 November 2011. The Board recommended the following changes to the first text of the IA:

- (1) The report should better clarify the scope of the initiative and provide further evidence on the effects of the problems identified.
- (2) The report should better explain the policy options and demonstrate their proportionality.
- (3) The report should provide a fuller assessment of the impact on business and SMEs.
- (4) The report should provide more operational arrangements for monitoring compliance and for the evaluation.

On reviewing a further draft, on 2 February 2012 the Board recommended:

- (1) The report should provide further evidence in problems identified.
- (2) The report should better explain policy options justifying the choice of options.
- (3) The report should provide a fuller assessment of the impacts on business and SMEs and explain how proportionality has been taken into account in the proposal.

On reviewing the final draft, on 30 March 2012 the Board recommended:

- (1) The report should provide further evidence in problems identified.
- (2) It should clarify which measures will be subject to level 2 measures.
- (3) It should be clearer in terms of impacts on business and SMEs.

These recommendations were taken on board.

1.3. External expertise and consultation of interested parties

The Commission Services has consulted and obtained information from the following sources:

A. European Insurance and Occupational Pensions Authority (EIOPA) and its predecessor (CEIOPS) which have provided advice and own-initiative reports.⁶

⁶ CEIOPS' Survey on proposals for amending IMD1, March 2008.
CEIOPS Advice to the European Commission on the revision of the Insurance Mediation Directive (2002/92/EC). CEIOPS' final report was delivered in November 2010.
EIOPA Report collecting, analysing and reporting on Consumer Trends, EIOPA-CCPFI-11/023 29 November 2011 (Annex 12).

B. Member States and stakeholders

- Representatives of the insurance sector (including CEA,⁷ BIPAR, FFSA, VVO, and GDV);
- Consumer organisations (including BEUC and FSUG);
- National supervisors;
- DG MARKT public hearing, which focused on scope, information requirements, conflicts of interest, cross-border trade, and professional qualification requirements;⁸
- DG MARKT meeting with experts from Member States and EIOPA to discuss the results of the public consultation and the possible structure and contents of IMD2;⁹
- A meeting on anticipated costs related to possible revisions of the IMD was held with relevant stakeholders; and
- Other discussions with consumer representatives (FIN-USE, Financial Services Consumer Group, and Financial Services User Group), regulators (Financial Services Committee, European Securities Committee, European Insurance and Occupational Pensions Committee) and industry representatives.

The large majority of the stakeholders present at these meetings supported the direction of the revision of IMD1 as outlined by the Commission Services.

The consultation process revealed a variety of stakeholder views on the issues discussed in this impact assessment.

C. Public consultation

A public consultation relating to IMD1 revision was carried out by the Commission Services from 26 November 2010 until 28 February 2011. 125 contributions were received.¹⁰ The answers to the consultation were broadly supportive of the direction of the revision as outlined by the Commission Services.¹¹

D. Studies ordered by the Commission Services

EIOPA report on Good Practices for Disclosure and Selling of Variable Annuities, EIOPA-CCPFI-11/019, 31 August 2011

https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/consultationpapers/CP%20No.%2083%20-%20Draft%20Report%20on%20Variable%20Annuities.pdf

⁷ A list of abbreviations can be found in Annex 1.

⁸ The minutes of the hearing can be found on the following website: http://ec.europa.eu/internal_market/insurance/docs/mediation/20101210hearing/panel-summary_en.pdf and the detailed results of the public consultation can be found in Annex 6.

⁹ The minutes of the meeting can be found in Annex 5.

¹⁰ A summary of the results of the public consultation can be found in Annex 6.

¹¹ The results are published at: http://ec.europa.eu/internal_market/consultations/2010/insurance-mediation_en.htm

Several specific studies ordered by different Commission Services were used to prepare this impact assessment.

- PricewaterhouseCoopers, Luxembourg (PwC), contracted by DG MARKT to conduct a study to provide a comprehensive overview of the functioning of insurance distribution in the EU¹².
- A study commissioned by DG MARKT in 2010 on the costs and benefits of potential changes to distribution rules for insurance products and for insurance PRIPs.¹³
- A study commissioned by DG SANCO to assess the quality of advice being offered across the EU.¹⁴
- A study ordered by DG SANCO on behavioural economic factors relating to investor decision making.¹⁵
- A study of the potential costs and benefits of different options for change in the area of sales rules for the distribution of non-MiFID PRIPs (early 2010) which provided evidence on market mapping and cost drivers.

E. Other studies

- Caceis Investor Services, Cross-border distribution of UCITS, May 2011¹⁶ ;
- Retail Distribution Review proposals: Impact on market structure and competition, Oxera (2009)¹⁷ ;
- Financial Services Authority, Conduct of Business sourcebook (COBS) post-implementation review: 2008 statement on interim findings (December 2008)¹⁸;
- AVIVA study on consumer attitudes¹⁹ ;
- City of London comparative report on the implementation of IMD1²⁰;
- Auswirkungen der EU – Vermittlerrichtlinie auf die deutsche Vermittlerlandschaft (March 2011)²¹;
- CEIOPS' report on the implementation of the IMD key provisions²².

¹² http://ec.europa.eu/internal_market/insurance/mediation_en.htm

¹³ http://ec.europa.eu/internal_market/consultations/docs/2010/PRIPs/costs_benefits_study_en.pdf

¹⁴ http://ec.europa.eu/consumers/rights/docs/investment_advice_study_en.pdf

¹⁵ http://ec.europa.eu/consumers/strategy/consumer_behaviour_en.htm

¹⁶ http://www.caceis.fr/fileadmin/pdf/reference_papers_en/cross-border-distribution-ucits-v2.pdf

¹⁷ http://www.fsa.gov.uk/pubs/other/oxera_rdr.pdf

¹⁸ http://www.fsa.gov.uk/pubs/other/COBS_review.pdf

¹⁹ <http://www.aviva.com/customers/consumer-attitudes-survey>

²⁰ http://www.cityoflondon.gov.uk/NR/rdoonlyres/00DF9852-33A5-4781-9338-BBFC7101133D/0/BC_RS_IMDfulllengthforwebFINAL.pdf

²¹ Christoph Schwarzbach, Christoph Klosterkemper, Ute Lohse, Johann – Matthias Graf v.d. Schulenburg, ZVersWiss (2011) 100:369-387

2. POLICY CONTEXT

2.1. Legislative framework

2.1.1. Legal situation before IMD1

A first step to facilitate the exercise of freedom of establishment (FOE) and freedom to provide services (FOS) for insurance agents and brokers was made by Council Directive 77/92/EEC of 13 December 1976. Barriers to the taking-up and pursuit of the activities of insurance and reinsurance intermediaries in the internal market remained. Therefore, the objectives of that Directive have not been achieved.

2.1.2. IMD1 – its scope, purpose, main provisions and implementation

IMD1 aims to provide a high level of consumer protection through the establishment of a clear legal framework as well as a high level of professionalism and competence among insurance intermediaries. A registration system for insurance intermediaries ensures the oversight of professional requirements as well as facilitating cross-border activities by way of freedom of establishment and freedom to provide services.

Scope: The Directive only applies to persons who provide insurance mediation services to third parties in exchange for remuneration.²³

Sales of insurance products conducted directly by insurance companies (direct writers) are not within the scope of the Directive.

There are also some intermediaries that are explicitly exempted from the scope,²⁴ and further exemptions from or inclusions in scope have been made by Member States when implementing the Directive (described in the problem definition).

Substantive requirements: IMD1 regulates the sales practices²⁵ of insurance agents and brokers and introduces some minimum basic registration, professional qualification and disclosure requirements. IMD1 is modelled from the perspective of a typical SME insurance intermediary (agent, broker) as most of intermediaries are SMEs (see section 2.2.4.)

²² https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/submissionstotheec/CEIOPS-DOC-09-07IMDReport.pdf

²³ According to Article 2.3 of the Directive, insurance mediation includes “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.” It **does not** include direct selling, i.e. when these activities are carried out by an insurance company or its employees.

²⁴ Art.1 of IMD1. Those sellers who are currently exempted from the scope work on an ancillary basis (they are not professional intermediaries). They do not sell life assurance contracts and their contracts do not cover any liability risks. The sale of these insurance products is complementary to the supply of goods or travel services by the seller and the amount of the annual premium does not exceed EUR 500; that is (pro rata) less than 2 euros per day. A typical example is an optician who sells complementary insurances on glasses, or a travel agent who sells a travel insurance policy.

²⁵ i.e. IMD1 regulates the relationship between the seller and the product manufacturer. See Annex 8 on the sale process

Although all Member States have implemented the Directive, no uniform application of the Directive could be achieved across the Union because its provisions led to differing interpretations in the Member States.²⁶²⁷

Implementation process: The Commission Services' check on the implementation of IMD1 from 2005-2008 showed that the transposition of the Directive varied considerably between Member States. The Commission opened 18 cases against 18 Member States, among which 13 have reached the first step of the infringement process (letter of formal notice) and 5 cases were referred to the Court. All cases are closed now as Member States complied with the Commission requests.

Among those 18 cases were:

14 cases of non-communication of national measures transposing the IMD1;

14 cases opened at own initiative by the Commission;

4 cases based on citizens' and business' complaints.

The Commission services regularly receive enquiries and complaints related to the application of IMD1. The Commission Services, the Member States and the supervisors were not in a position to achieve uniformity in the application of the Directive because its provisions are very high level and lead to different interpretation.²⁸

The objectives of IMD1 were adequately met and the Directive has allowed an efficient protection of consumers as stated in CEIOPS' report on the implementation of the IMD key provisions (CEIOPS Doc 09/07, *see supra*). However, it could be considered that IMD1 was the first attempt to regulate the insurance sales market and as such it could not cater for the increased need for transparency and consumer protection in the sector without being up-dated²⁹.

A comparative report on the implementation of the IMD1 illustrated problems that can arise due to national differences in the implementation of IMD1.³⁰ The implementation check brought to light that in some Member States there are regulatory and/or supervisory gaps, e.g. insurance PRIPs are only regulated by the IMD to a minimum level while comparable and substitutable financial products are more substantially regulated by the MiFID. This concerns mainly investments

²⁶ ABI Research Paper, Impact of commission disclosure in general insurance personal lines, Analysis of the motor and travel insurance markets, Report from Charles River Associates, 2010, General Insurance Disclosure Research, Research Report prepared for Financial Services Authority by IFF Research Ltd 17 July 2008, Information versus Persuasion: Experimental Evidence on Salesmanship, Mandatory Disclosure and the Purchase of Income and Loan Payment Protection Insurance David de Meza, Bernd Irlenbusch, Diane Reyniers, London School of Economics, November 2007, SME Insurance, Commission Report, Research carried out by NMG Financial Services Consulting, November 2008.

²⁷ CEIOPS' 2007 Report on the Implementation of the Insurance Mediation Directive's Key Provisions, <http://www.ceiops.eu/media/files/publications/submissionstotheec/CEIOPS-DOC-09-07IMDReport.pdf>.

²⁸ CEIOPS' 2007 Report on the Implementation of the Insurance Mediation Directive's Key Provisions, <http://www.ceiops.eu/media/files/publications/submissionstotheec/CEIOPS-DOC-09-07IMDReport.pdf>.

²⁹ This trend is reflected in the EIOPA study on Consumer Trends, attached in Annex 12 of this Report

³⁰ See footnote 22.

packaged as life insurance policies (notably, unit-linked, index-linked and certain with-profits products see hereafter as "insurance PRIPs"³¹).

2.1.3. Other relevant EU legislation and ongoing policy initiatives

Solvency II³² includes rules on product disclosure³³ related to all insurance products (including general insurance and life insurance). Its main purpose is to introduce prudential rules on insurance and reinsurance undertakings. It does not deal with selling practices or include consumer protection rules.

MiFID³⁴ regulates the selling practices of investment products and serves as a benchmark for the revision of the IMD with regard to the selling practices of life insurance policies with investment elements.

The PRIPs initiative aims at ensuring a coherent horizontal approach to product disclosure with regard to investment products and insurance products with investment elements (so-called insurance PRIPs³⁵), and provisions on selling practices will be included in the revisions of the IMD and MiFID.

The following table is designed to show the synergies and interrelations between different upcoming initiatives.

Table 2

	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</u> insurance products, cross-border, conduct of business,	MiFID II Registration and authorisation rules, organisational requirements (including qualification of staff), selling practices of all investment products, cross-border, conduct

³¹ An insurance PRIP is an insurance product which offers a surrender value or where that surrender value is wholly or partially exposed, directly or indirectly to market fluctuations.

³² Directive 2009/138/EC of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II), JO L 335, p.1

³³ Product disclosure is done by a document (or group of documents) which describe a financial product or service, including the features, benefits, cost and risks associated with that product.

³⁴ Directive 2004/39/EC of 21 April 2004 on markets in financial instruments (level 1), JO L 145.p.1.; and Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC (level 2), JO L 241.p.26.

³⁵ See the scope in the Impact Assessment on PRIPs: http://ec.europa.eu/internal_market/finservices-retail/docs/investment_products/29042009_impact_assessment_en.pdf

See definitions in the section on problems.

	supervision, etc. <u>Sales of insurance products with investment elements, such as unit-linked life insurance are regulated under IMD.</u>	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 PRIPS UCITS³⁶ Insurance products Insurance products with investment elements Investment products	

Currently sellers of insurance products with investment elements (insurance PRIPs) do not have to comply with consumer protection rules comparable to those selling investment products. This impact assessment will analyse how MiFID consumer protection provisions could be applied proportionately to sellers of insurance PRIPs, because of the complexity, the similarity and proven substitutability of these products³⁷. It should be noted that when MiFID II passes through the Parliament and the Council, the IMD needs to follow its changes, in order to achieve consistency in legislation which regulates similar products.

2.2. Structure of the insurance distribution markets in the EU

2.2.1. Market size

The European insurance sector is the largest insurance sector in the world, with a 37% share of the global market³⁸. At year-end 2009, the sector comprised a total of 4,753 undertakings, with annual gross written premiums for the sector being approximately €1,028bn³⁹. The sector is diverse in its size (large insurance undertakings, mutuals, small insurance intermediaries, and some large multinational companies which represent only about 5% of the market), its nature (mutual and publicly listed) and its complexity (both complex and less complex). At the end of 2010, European insurers' investments in the global economy represented 54% of the GDP of the European Union. The European insurance industry employs almost 950,000 people directly and a further million are outsourced employees and independent intermediaries⁴⁰. Many insurance products have a high social value because of the role they play in retirement and healthcare provision. They also have a high economic value by allowing individuals to be less risk-averse, thereby contributing to economic activity and stability.

2.2.2. Insurance products

Box 1 Categories of insurance policy

Life insurance is a contract between the policyholder and the insurer, whereby the insurer agrees to pay a designated beneficiary a sum of money upon the occurrence of the insured individual's or another individuals' death or some other event affecting such individual, such as terminal illness or

³⁶ The UCITS (Undertakings for Collective Investment in Transferable Securities) Directives have been the basis for an integrated market facilitating the cross-border offer of collective investment funds. UCITS are investment funds that have been established in accordance with UCITS Directive. Once registered in one EU country, a UCITS fund can be freely marketed across the EU.

³⁷ See impact assessment on PRIPs. (to be published together with the proposal later)

³⁸ CEA paper European Insurance – Key Facts, published September 2011, available at <http://www.cea.eu/uploads/Modules/Publications/key-facts-2011.pdf>

³⁹ EIOPA Report on the fifth Quantitative Impact Study (QIS5) for Solvency II https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/QIS5_Report_Final.pdf

⁴⁰ CEA paper European Insurance – Key Facts, published September 2011

critical illness. In return, the policyholder agrees to pay a stipulated amount (at regular intervals or in lump sums). The classes of life insurance are listed in Annex 2 of the Solvency II Directive. For the purpose of the revision of the IMD there are two categories of life insurance policies: the first category covers the riskier and more complex products which are, in substance, investments. Those products fall under the PRIPs initiative: they are so-called investments packaged as life insurance policies (notably unit-linked, index-linked and certain with-profits products, hereafter life insurances with investment elements). The second category covers life insurance products which are easily understandable for consumers and have a long tradition such as a term life insurance policy, which pays a specified amount of money if the policyholder dies during the term of the policy (pure life insurances).⁴¹

General insurance or non-life insurance policies, such as automobile and homeowners' policies, provide payments depending on the loss suffered from a particular event. General insurance comprises any insurance that is not determined to be life insurance. The classes of non-life insurance are listed in Annex 1 of the Solvency II Directive. The scope of this impact assessment covers all insurance products.

In some countries, a very high proportion of people have home, health or car insurance; for example, in the Netherlands 88% of people do so; in Sweden 88% and in Denmark 86%. In Bulgaria, however, only 20% of respondents say they have these insurance products, and 25% in Poland.

The geographical pattern is very similar in the case of life insurance. At least a third of citizens in 16 Member States have life insurance, whilst a majority holds this type of product in Sweden (60%) and Denmark (53%). Yet in three Member States, fewer than one in 10 have life insurance: Bulgaria (5%), Greece (6%) and Romania (8%).⁴²

2.2.3. *Market operators and distribution channels (Annex 8)*

Insurance distribution structures across EU insurance markets are diverse and complex. Insurance products are sold directly by insurers and through insurance intermediaries. Both use different means of distance marketing (e.g. by telephone and, increasingly, through internet web-sites). The main market players include intermediaries (agents, independent brokers and bank-assurers), a significant proportion of which are SMEs, and direct writers (insurance companies). There are several types of intermediaries. Brokers sell and compare several insurance products. Tied agents are those who exclusively sell the products of one insurance undertaking. Multi-tied and non-tied agents work with several insurance undertakings but they do not sell competing products.

In Europe, non-life insurance products are mainly provided by intermediaries (i.e. agents, brokers and bank-assurers), but there are important national differences in market structure (examples):

⁴¹ International Financial Reporting Standard 4 (IFRS 4) "Insurance Contracts" was issued by the International Accounting Standards Board (IASB) in March 2004., Annex B 19. According to the International Financial Reporting Standards (IFRS), an insurance contract is contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder. The definition of an insurance contract refers to insurance risk, which this IFRS defines as risk, other than financial risk, transferred from the holder of a contract to the issuer. A contract that exposes the issuer to financial risk without significant insurance risk is not an insurance contract.

⁴² Eurobarometer., http://ec.europa.eu/public_opinion/archives/eb/eb75/eb75_en.htm

- Agent- and broker-driven markets: the UK, Germany, the Netherlands, Belgium, Ireland, Italy, Poland, Austria, Portugal, Luxembourg, Bulgaria, Romania.
- Direct writer-driven markets: France, Spain, Finland.

The table below provides an example of how markets are organized in different Member States in view of the various distribution channels in the non-life insurance sector.

Table 3

Source: "London Economics"

Market shares of the various insurance distribution channels in the EU (in %) - selected countries (non-life insurance)				
	Insurance Intermediaries (brokers+agents)	Banks/Post Offices	Direct Insurance	Other
Austria	48	5	43	4
Belgium	73.4	6.3	20.2	-
Czech Republic	65	3	29	3
Denmark	15	5	40	40
Estonia	60	10	30	
Finland	15	10	70	5
France	53	9	33	3
Germany	87	5	1	7
Greece	88			12.5
Ireland	75		25	
Italy	91.5	2	6.5	0.1
Lithuania	36	0	48	15
Luxembourg	80	3	6	11
Malta	60		30	10
Netherlands	42	17	38	3
Poland	69.3	7.4	23.2	0.1
Portugal	70.6	9.9	12.6	6.9
Romania	60	10	30	-
Slovakia	59			41
Spain	61.53	8.48	18.21	11.78
Sweden	55			45
UK	Personal lines: 42 Commercial lines: 88	Pers.: 16 Comm.: 0	Pers.: 31 Comm.: 9	Pers.: 11 Comm.: 3

Source: National associations, members of BIPAR (February 2010 - estimates)

Overall, in this group of 20 Member States, intermediaries accounted for slightly more than 80% of all insurance premiums collected in 2008. In none of these Member States the intermediaries' share of total premiums (life and non-life) is less than 50%.⁴³

2.2.4. Role of SMEs in the insurance markets

About 95% of registered insurance intermediaries in the EU are micro enterprises and SMEs (as defined by other EU Directives⁴⁴). 80% of travel agents and car rental

⁴³ [http://psead.com/userfiles/attach_Extracts_from_Draft_LE_Report\[1\].pdf](http://psead.com/userfiles/attach_Extracts_from_Draft_LE_Report[1].pdf)

⁴⁴ The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million. Within the SME category, a small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million. Within the SME category, a microenterprise is defined as an enterprise which employs fewer than 10 persons and whose annual

companies which sell insurance products are SMEs. Some loss adjusters and claim handling companies involved in after-sales services are also SMEs. No direct sellers or banks are SMEs.

Banks, internet operators and direct writers compete with insurance intermediaries. SMEs intermediaries make insurance more accessible to consumers and smaller businesses. Thanks to intermediaries, more people and businesses have access to a broad range of insurance products.

Insurance intermediaries: around 750 000 entities operating in the EU, of which SMEs: 95%
Direct writers: 4618 undertakings in the EU. Insurance companies cannot be SMEs due to prudential and consumer protection rules.
Travel agents: 68 000 undertakings in the EU, of which SMEs: 80%
Car rentals: 30 976 undertakings in the EU, of which SMEs: 80%.

3. IDENTIFICATION OF PROBLEMS

3.1. General problems related to IMD 1 on both insurance and insurance PRIPs products

The following main problem areas relating to IMD1 have been identified:

PROBLEM DRIVERS	DIFFERENT IMPLEMENTATION OF IMD 1 IN MEMBER STATES					Divergence in contract law and in taxation regimes in Member States
	DIVERSITY OF PRODUCTS (NON-LIFE / LIFE / INVESTMENT PRODUCTS)					
PROBLEMS	IMD scope does not cover all distribution channels: e.g. direct writers, travel agents, car rentals, etc.	Remuneration structures creating conflicts of interest	Buyer does not know Seller/Product: diverse pre-contractual information and advice standards	Seller does not know Buyer/Product: Professional qualifications levels are diverse	Registration and notification systems are fragmented across the EU	Non-harmonised administrative sanctions on infringements of sales rules
	Uneven playing field due to unclear IMD 1 scope and regulatory patchwork	Conflicts of interest at the point of sale: Remuneration structure and links between direct writer and intermediary	Advice provided by sellers of insurance policies is biased due to the conflicts of interest or of insufficient quality	Burdensome for insurance intermediaries and direct writers to enter markets on cross-border basis	Sanctions in insurance distribution are insufficiently deterrent	
	DISTORTED COMPETITION: Different seller of similar insurance products (direct writers, insurance intermediaries, travel agents, car rental companies, investment advisors, etc.) are not regulated in the same way		CONSUMER DETRIMENT: The prices of the products are higher and the variety of the products is lower due to the restricted access of certain market players to the market and the lack of appropriate and qualified advice		IMPEDED MARKET INTEGRATION: Low level of cross-border trade in financial services	

In this chapter we discuss the existing problems in these five areas. Most problems are similar for "classic" insurance (life and non-life insurance) and for PRIPs, but, due to the complex nature of the latter, certain aspects of these are dealt with in a separate section.

turnover and/or annual balance sheet total does not exceed EUR 2 million. See: http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pdf

3.1.1. Narrow scope

3.1.1.1. Which sellers of insurance fall outside the scope of IMD1?

Under IMD1 the information requirements aiming to protect consumers apply only to those intermediaries that are in scope of the Directive. As explained above, insurance companies (direct writers) and sellers of certain insurance products on an ancillary basis who fulfil certain conditions and where the premium does not exceed EUR 500 per year (such as mobile phone sellers and travel agents) are excluded from scope.

Figures from all Member States – with the exception of Belgium, the Netherlands, Romania and Denmark - show that 49% of the sellers of insurance products and other market players involved in the after-sales process (e.g. direct writers, car rental firms, bank-assurers, travel agents, claims handlers, loss adjusters, etc.⁴⁵) fall outside the scope of IMD1. This unevenness in terms of information provisions undermines consumer protection.

There is some evidence to suggest that a number of consumer complaints relate to sales by some of these sellers which are outside the scope, particularly, travel insurance sold by travel agents⁴⁶. Studies shows that in the UK, 67% of consumers buying from a travel agent believe that most travel insurance policies are much the same. It has been found that 97% of consumers want all companies selling travel insurance to be required by law to explain to customers the details of the policy they are buying.⁴⁷ Association of travel agents and car rental/leasing companies agreed to be subject to a lighter version of the IMD.⁴⁸

As for loss adjusters, the European Court of Justice recognises in one of its judgements that a loss adjuster is not necessarily a technical expert. He protects the interests of his principal (the insurer). The activity of loss-adjustment is done during the investigation of claims. Nevertheless the final decision as to the amount to be paid rests with the insurer. The injured party cannot apparently bring an action against the loss-adjuster which leads to conflicts of interests.⁴⁹ During the preparatory work of the Directive, loss adjusters themselves advocated for sectoral passports/mutual recognition environment in order to boost their cross border trade.⁵⁰

Several consumer organisations suggested that the definition of insurance intermediation should be built on a pure activity-based principle, meaning that any market player pursuing the activity of selling insurance products on a professional basis should be regulated by the Directive.⁵¹

Member States have interpreted the scope provisions of Article 1(2) differently. Whereas some Member States have extended the scope of the Directive only to cover

⁴⁵ See PwC study, p.17. and further

⁴⁶ While in France only 2.3% of all complaints related to sales of travel insurance, in Hungary for example this figure is more than 9%. Hungarian Supervisory Authority statistics 2011 - http://www.pszaf.hu/data/cms2322251/fogyved_beadv_2011Q3.pdf.

⁴⁷ <http://www.biba.org.uk/UploadedFiles/5traveltreasury.pdf>

⁴⁸ <http://www.ectaa.org/Home/Publications/RecentPosition/tabid/101/language/en-US/Default.aspx> and

⁴⁹ The European Court of Justice expressed its views on the nature and activities of the independent loss adjuster in a ruling of 1977 (Ameyde v UCI, C-90/76) under numbers 3 - 5 of "facts and procedure".

⁵⁰ Letters from FUEDI to the European Commission,,www.fuedi.eu.

⁵¹ See Annex 6, results of the public consultations

direct writers, others, such as the UK included in its scope also travel insurance, as a relatively complex product yielding consumer protection benefits⁵². There are, however, some 68 000 travel agents and tour operators in the Union selling 90% of travel policies which are not subject to the IMD's requirements.

Similarly, people who give consumers information about insurance intermediaries or undertakings are regarded as within scope in the UK, but not in some other Member States. And finally in some Member States car rental companies are exempted when selling insurance products.

It is therefore clear that the scope of both the IMD and domestic regulation varies between Member States.

The responses to the public consultation and the discussions at the public hearing clearly identified the unclear scope as problematic. EIOPA and the vast majority of stakeholders were in favour of clarifying and amending the exemptions in Article 1(2) IMD in order to reduce the risk of confusion for consumers and the variation of levels of consumer protection between Member States. The lack of clarity concerning the scope of those persons covered by IMD requirements also raises a single market issue insofar as those persons that are outside the scope of the IMD will not be able to derive a passporting right from it, thus creating an unlevel playing field at a European level.

3.1.1.2. Which buyers of insurance fall outside the scope of IMD1?

Buyers of insurance products can be differentiated according to their profile (business clients or consumers) and according to the size of the risk to be insured. Most policies are issued to consumers. For example, in 2009, more than two thirds of all newly concluded life insurance contracts were with individuals (not group life insurance policies)⁵³.

Business clients have been excluded from the specific protection rules designed for consumers in all financial services legislation (including MiFID), except in insurance. In insurance, size criteria are used, and in the case of "large risks", i.e. risks above a certain threshold⁵⁴ (normally business risks), insurance intermediaries do not need to apply the information requirements.

Some respondents to the public consultation, notably the consumer organisations, state that the disclosure requirements for IMD2 should be aligned with the approach in other areas of financial services. Most stakeholders therefore argued that the scope of IMD1 should be any natural person plus SMEs, but professional clients should be excluded. The vast majority of stakeholders also believe that the current exemption for insurance intermediaries from requirements to provide information in the "large risks" area (e.g. a person who buys insurance cover for his private airplane) is useful and should be maintained.

⁵² Regulating connected travel insurance http://www.fsa.gov.uk/pubs/cp/cp07_22.pdf.

⁵³ CEA statistics 2009.

⁵⁴ Art 12(4) IMD1

3.1.2. *Conflicts of interest*

Insurance contracts are often complicated and difficult to understand for consumers.⁵⁵ Intermediaries therefore play an important role in processing information for the consumer and guiding consumers in choosing suitable insurance policies. Some studies actually suggest that intermediation is a necessity in some areas of insurance.⁵⁶

But an intermediary may be confronted with a conflict of interest stemming from the way in which he is remunerated. Sometimes the intermediary is remunerated by the client (by way of a “fee”), but often the intermediary will be paid by the insurance undertakings whose policies he sells (by way of a “commission”). Often the customer is not aware of the way in which the intermediary is remunerated or what relationship he has with the insurance undertaking.

Conflicts of interest stemming from remuneration structures can lead to consumer harm in two slightly different ways: either through a lock-in of 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 biased advice (see next section) to the consumer.

In the 2007 Commission Business Insurance Sector Enquiry, the Commission Services found that the dual role of brokers may impact the objectivity of their advice⁵⁷. This could lead to a situation where customers do not trust advice from intermediaries and other financial advisers. In a study led by AVIVA⁵⁸ in 2008, 49% of those interviewed trusted recommendations by friends, family and other informal sources more than those of professionals. Only 35% of those interviewed relied on professional advice. In Hungary this figure was only 17%. The lack of trust and of information about the links between the intermediary and the company could therefore have a negative impact on the market, by restricting choice and competition.

Since IMD1 does not contain information requirements relating to the remuneration of intermediaries or the disclosure of their relationship with the direct writer (other than in relation to certain shareholding thresholds), Member States are free to impose their own rules. The vast majority of Member States (21 out of 27) have left this area totally unregulated, whilst other Member States have introduced stricter rules; for example, the United Kingdom, the Netherlands, France, Sweden, Denmark and Finland have introduced additional information requirements. These variations in national rules mean that consumers in different Member States are not protected to the same extent. They also result in an unlevel playing field between sellers of insurance products which operate on a cross-border basis and, in some Member States, between sellers of insurance and investment products of a similar nature.

⁵⁵ Aviva survey on consumer attitudes: <http://www.aviva.com/customers/consumer-attitudes-survey/>; DG SANCO research on behavioural economics:

http://ec.europa.eu/consumers/dyna/conference/economics_en.htm.

⁵⁶ DG SANCO study of non-profit entities providing General Financial Advice (GFA) across the European Union; http://ec.europa.eu/consumers/rights/docs/mapping_nonprofit_entities_en.pdf

⁵⁷ http://ec.europa.eu/consumers/rights/docs/investment_advice_study_en.pdf

⁵⁸ Aviva survey on consumer attitudes: <http://www.aviva.com/customers/consumer-attitudes-survey/>

3.1.3. Advice and professional qualifications

The quality of the service provided by insurance intermediaries and sellers of insurance products depends on professional competence. As indicated above, the scope of IMD1 is limited and many market players are exempted and thus not subject to any professional qualification rules. In addition, the rules in IMD1 are too general and do not differentiate between complex and simpler products.

The majority of Member States divide intermediaries into different categories. The most common division is that between insurance agents, insurance brokers, sub-agents and insurance consultants, and some have chosen to use the definition of tied insurance intermediary in Article 2(7). In some Member States, a qualifying examination is necessary to become an agent or a broker, and in others it is necessary to attend a training course, which can range from 50 hours to a maximum of 500 hours. Some Member States require experience which can vary from 6 months to 4 years. In particular, complicated products, such as life insurance products with investment elements (insurance PRIPs), might require higher levels of knowledge and ability from the insurance intermediary.

Unsuitable or low quality advice leads to consumers buying products they do not need, or products not adapted to their needs. This creates higher costs and increases the risk of default under, or cancellation of, the insurance policy, resulting in extra costs.⁵⁹

According to consumer groups responding to the public consultation (FSUG, the German association of consumers and BEUC) a definition of "advice" should be introduced, meaning an independent service to consumers. Consumer groups advocate that a definition is very important so that it gets possible to distinguish between information, advertising and personalised advice which can only be given and products proposed after the needs and demands of the consumers have been actively detected and analysed by the intermediary. In Germany, insurance intermediaries try to avoid giving "advice" to consumers. In a telephone survey, only 52 % of the consumers received "advice" from insurance intermediaries. According to consumer groups, if advice is inaccurate or of poor quality, consumers make wrong choices and buy (or, rather, are sold) the wrong products (including, for example, policies under which they are over- or under-insured).

Consumer dissatisfaction: the number of complaints in relation to insurance products is on the increase, according to information from dispute resolution bodies across Europe. There is about a 30% increase in the total number of complaints addressed to the insurance mediator in France in 2011, compared to 2010,⁶⁰ while in Poland the number of complaints about the sales of insurance policies in general has tripled between 2007 and 2010.⁶¹ In 2010 the Belgian insurance ombudsman had received some 10% more complaints than during the previous year,⁶² and in Hungary the

⁵⁹ See more in section 8.5 on benefits.

⁶⁰ Le Médiateur de la Fédération Française des Sociétés d'Assurances, Rapport Annuel 2010

⁶¹ Sprawozdanie Rzecznika Ubezpieczonych Za 2010 Rok

http://www.rzu.gov.pl/files/3089_5164_Sprawozdanie_Rzecznika_Ubezpieczonych_za_rok_2010.pdf

⁶² Annual report of the Belgian Insurance Ombudsman 2010

http://www.ombudsman.as/fr/documents/Rapport_Ombudsman_2010.pdf

number of complaints registered with the financial supervisory authority has doubled between 2007 and 2009.⁶³

Without adequate level of professional qualifications, there is a risk of the quality of insurance advice being undermined, which could potentially lead to consumer detriment.

3.1.4. *Cross-border business*

The market for cross-border insurance services in general, irrespective of the means of marketing, is still very limited in the retail insurance sector. Evidence suggests that only global and multinational business insurance intermediaries, serving major multinational and domestic firms, and providing a wide range of services in addition to traditional brokerage, establish themselves in several Member States.

When an intermediary wants to sell insurance products cross-border under the freedom to provide services (FOS), he must notify his intention to the competent authority of his home Member State (which must notify the host Member State) and go through a notification procedure. Several respondents to the public consultation from the insurance industry and insurance intermediaries, as well as EIOPA, acknowledged that there is room for improvement as cross border business is hampered by current legislation. There are different approaches to the FOS problem in current EU legislation, all of which appear more favourable than that under IMD1.⁶⁴

The total cross-border life insurance business was roughly 5% in 2007. In 2008, the business declined due to the financial crisis. In non-life segment, the cross border business accounts for 8% of total non-life business. The majority is industrial and P&C insurance.⁶⁵

There is no single EU register for insurance intermediaries where a consumer can easily find information about registered sellers of different insurance products. As a consequence, sellers of insurance products lack easy access to information about how to go cross-border and this has a negative impact on competition in the EU insurance market.⁶⁶

⁶³ Hungarian Supervisory Authority statistics - http://www.pszaf.hu/data/cms2136356/2009_IV_negyedevves_panaszkezelesi_taj.pdf

⁶⁴ Under Solvency II and MiFID, the intermediary can go cross-border immediately upon notification by home to host Member States. In the banking area, the intermediary can go cross-border immediately upon receipt by the Home State of the firm's intention to passport under FOS.

⁶⁵ Source: Data based on Swiss RE data from World Insurance report 2008 own calculation, http://www.towersperrin.com/tp/getwebcachedoc?webc=USA/2009/200911/Emp_09-3_Art-3_Europ-Web.pdf, plus Communication of the Commission on the review of the DMFS Directive (2002/65/EC) http://ec.europa.eu/consumers/rights/docs/com_review_distance_mark_cfsd_en.pdf. The data collected in the Report comes from Eurobarometer 2008 and are based on material obtained prior to the economic and financial crisis. This means that during and after the crisis, the percentage of cross-border trade in financial services is even lower. There is no more recent data available dealing with cross border business.

⁶⁶ Annex 6, results of the public consultation.

3.1.5. Sanctions in insurance distribution

At present, sanctions are not harmonised in any financial services legislation at EU level and the analysis of national sanctioning regimes has shown that they are divergent and not always sufficiently deterrent⁶⁷.

In the insurance sector, a preliminary mapping exercise of national sanctioning regimes was carried out in 2009 by EIOPA (then CEIOPS). EIOPA gathered additional information⁶⁸ from 13 Member States (these are enumerated in the Annex 15) by means of a questionnaire on the administrative sanctions in national legislation for violations of the obligations foreseen in the laws transposing IMD1.

The most common violations of IMD1 are: a failure of insurance intermediaries to register, or the use of unregistered intermediaries by insurance undertakings (Art. 8 (1)-(2)); a failure to comply with professional requirements (appropriate knowledge and ability, good repute "fit and proper" conditions, (Art. 4); a failure to comply with information requirements (Art. 12); and a failure to provide a fair analysis where an intermediary gives advice under Article 12 (2).

The most common problems in national sanction regimes related to breaches of the rules laid down by the IMD are (see Annex 15 for details):

- (a) Lack of powers for competent authorities
- (b) *Low number of sanctions issued*
- (c) *General lack of deterrence, lack of publication of sanctions issued*
- (d) *A level of fines which is too low*

The majority of respondents in the public consultation on the Communication on sanctions (governments, some industry representatives, consumers/investors associations) share the view that lack of important sanctioning powers and appropriate criteria for the application of sanctions may send the message that the consequences of illegal behaviours are not serious, which will not discourage such behaviours.⁶⁹

The problems mentioned above give a very strong signal that the enforcement system is not working. Authorities often lack powers; other authorities do not enforce the rules. The fines vary for instance between a minimum of 25 EUR (Belgium) and a maximum of 100 million EUR (France). The low level of sanctions confirms the general feeling among many consumers that complaints to insurance companies or to the authorities do not lead anywhere. Input from EIOPA and national insurance

⁶⁷ Problems arising from this have already been discussed in the Impact Assessment concerning the Commission's Communication on sanctions in financial services in 2010.

⁶⁸ CEIOPS' Report to the European Commission on EU Supervisory Powers, Objectives, Sanctioning Powers and Regimes: https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/Supervisory-powers-rep-09/CEIOPS-report-on-supervisory-powers.pdf

⁶⁹ Replies to the consultation can be found at http://ec.europa.eu/internal_market/consultations/2010/sanctions_en.htm

ombudsmen gives similar indications⁷⁰. Market actors can use the freedom to provide services or to establish themselves in countries with a lenient regime.⁷¹

Divergences and weaknesses in national sanctioning regimes may prevent the development of a level playing field within the Internal Market: unequal treatment of violations in different Member States, along with other regulatory divergences, risks creating competitive disadvantages for insurance intermediaries from certain Member States. Despite the current low level of cross-border activities in the insurance mediation sector, it cannot be excluded that market players subject to IMD rules (which will include cross-border insurance undertakings) may exploit differences between sanctioning regimes in different Member States.

The main conclusion from a recent Eurobarometer report is that consumers in Europe continue to feel powerless in relation to insurance providers: 65% of consumers believe they will never win in a dispute with an insurance company and 60% believe that "you never can be sure of your insurance cover". This impacts the number of complaints and the number of sanctioning cases.

3.2. Problems relating to Packaged Retail Investment Products (PRIPs)

The problems explained above are similar, but even more pronounced, in the case of investment based insurance products, because of their high complexity. This section presents evidence for the above-stated problems in the context of PRIPs insurance products.⁷²

Consumer protection standards for the sales of insurance PRIPs⁷³ are not sufficient at EU level, as IMD 1 does not contain special rules for the sales of life insurance products with investment elements, which are generally more complicated than other insurance products. Currently, those products are sold under the general rules for the sales of insurance products, even though these products are very different in nature and generally represent higher risks for retail consumers.⁷⁴

There is market evidence of a **very high number of complaints** regarding the sale of unit-linked insurance products in many Member States. For example, in France these complaints were about one third of all complaints in 2010⁷⁵. In Hungary, about 15%

⁷⁰ https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/IMD-advice-20101111/20101111-CEIOPS-Advice-on-IMD-Revision.pdf

⁷¹ More evidence can be found in Annex 15.

⁷² There is a key difference between the sanctioning regime established by PRIPs Regulation and those of the IMD2. Key violations of PRIPs regulations are linked to product disclosure whilst the IMD2 will deal with key violations of selling practices. One breach cannot be sanctioned twice as the types of breaches are different. Further explanations can be found in Annex 3.

⁷³ The PRIPs market has three key characteristics (as described in the IA on PRIPs from May 2011): 1. Powerful asymmetries of information exist between retail customers and the industry, requiring robust regulatory interventions; 2. There is a proliferation in products taking different legal forms and structures yet offering comparable risk/reward profiles; and 3. The regulation of different product types greatly varies depending on the product's legal form rather than its economic nature (e.g. risk/reward profile).

⁷⁴ Annex 12 - EIOPA Report on Consumer Trends November 2011

⁷⁵ Le Médiateur de la Fédération Française des Sociétés d'Assurances, Rapport Annuel 2010

of the registered complaints in 2011 related to sales of unit-linked insurance, and they had doubled in relation to the previous year⁷⁶.

Many responses from **consumer organisations** to the Call for Evidence on unit-linked life insurance policies highlighted deficiencies with regard to the sale of these products and of the costs associated with this type of investment. Regulators have reported that differences in regulation between life insurance products and mutual funds have caused significant problems.

A **recent example** of such a potential distortion in sales is the alleged mis-selling of equity-linked insurance products in the Netherlands, which resulted in a class action lawsuit. The complaint was that there was insufficient disclosure of the costs associated with those policies, leading to investment returns that were significantly lower than investors had been led to expect and to penalties on early withdrawal that were not expected. There are other examples; for instance, a Belgian consumer association has warned that rules on advertising unit-linked life insurance in Belgium do not specify how information on past returns should be presented so as to avoid misleading prospective investors.⁷⁷

The **substitutability of MiFID** investment products and insurance-based investments was highlighted by a recent study of retail investment services for DG SANCO. The study, reporting on the results of mystery shopping⁷⁸ for investment products across the EU, indicated that in fact almost 20% of mystery shoppers received a recommendation to buy unit-linked life-insurance policies⁷⁹. This shows that, when consumers are looking for investment products, they might be sold either pure investment products or insurance products with investment elements. This proves the substitutability of those products.

This is also apparent from the availability of ‘open-architecture’ insurance products that provide investment exposure to the performance of UCITS or other MiFID products.⁸⁰

The aforementioned SANCO Study on Advice observed that countries with an especially high incidence of "**unsuitable product recommendations**" tend to be the ones with more developed financial industries, for example, Denmark (68%), Finland (56%), Netherlands (52%), Sweden (58%), the UK (55%). It was concluded that, out

⁷⁶ Hungarian Supervisory Authority statistics - <http://www.pszaf.hu>

⁷⁷ See the above mentioned Consumer report. (EIOPA Report on Consumer Trends November 2011)

⁷⁸ Mystery shopping (or a mystery consumer) is a tool, used externally by market research companies or watchdog organizations or internally by companies themselves, to measure quality of service or compliance to regulation. Mystery shoppers perform specific tasks such as purchasing a product, asking questions, registering complaints or behaving in a certain way, and then provide detailed reports or feedback about their experiences.

⁷⁹ *Consumer Market Study on Advice within the Area of Retail Investment Services – Final Report*, prepared for European Commission, DG Heath and Consumer Protection by Synovate, 2011, see reference above)

⁸⁰ For example, a recent analysis of the distribution of UCITS by Caceis Investor Services placed insurance wrappers (together with retail and private banks and Independent Financial Advisers), as the main distribution channels of UCITS, ahead of fund platforms and direct selling. Evidence of the substitutability of insurance-based investments and MiFID investments in the UK comes from both the popularity of unit-linked bonds over more traditional life assurance-based investments – they accounted for 48% of the single premium life market in the UK – and the growth of wrap platforms and fund supermarkets. The above mentioned trend can also be witnessed in other Member States.

of all sales of investment products (regulated under MiFID 1), 57% were based on unsuitable advice.

Unsuitable financial advice has a significant impact on **investor losses** and **investor confidence**. It has been observed through anecdotal evidence that for one type of life insurance products, variable annuities, in about 25% of cases consumers withdraw from the contracts before they mature (*see the impact section for the estimated benefits*). But a study in Germany indicates that consumers terminate 50% to 80% of all long-term investments prematurely because of unsuitable advice when buying financial products. This leads to estimated losses to consumers of 20-30 billion Euros every year⁸¹. The issue of unsuitable advice may be symptomatic of a wider problem within the EU. For example, recent data provided to the Commission by the FIN-NET network showed an increase in the number of complaints relating to financial advice on investment products, specifically in Italy, Ireland, France, and Belgium.

In the absence of EU rules **regulators have responded differently** by asking for increased transparency (for instance remuneration disclosure) or, where their action captures complex products in general, providing guidance on pre-contractual disclosure or calling for a moratorium:⁸² (see the text in the following box for more information).

In Belgium: the supervisory authority has examined the trend towards increased complexity and has recently taken the initiative to launch a moratorium on the distribution of unnecessarily complex structured products to retail investors (life insurance contracts included).

In Finland, the supervisory authority is preparing regulations and guidelines on disclosure of costs and profits of life insurance policies. The new requirements are based on the inspections by the Finnish supervisory authorities and their finding that there is no adequate transparency in disclosure of costs of underlying investments. The insurer will have to disclose the costs related to the underlying investment products in a more detailed way than before⁸³.

In France, the supervisory authority (Autorité de Contrôle Prudentiel – ACP) has issued a recommendation concerning the use of structured financial instruments as units of account that carry a risk of mis-selling due to their complex nature. The recommendation sets out how insurers and insurance intermediaries can comply with their legal and regulatory obligations in terms of information and advice to consumers who wish to buy such products, including unit-linked life insurance products.

4. SUBSIDIARITY

4.1. How would the problem evolve without EU action? The base line scenario

If IMD1 is not revised, it is very likely that the problems that have been identified will persist and could be aggravated by future market developments, as very few counterbalancing factors are likely to appear. On the major issue of consumer

⁸¹ Study of Evers and Jung, Anforderungen an Finanzvermittler, September 2008, launched by the German Consumer Affairs Ministry.

⁸² EIOPA Report on collecting, analysing and reporting on Consumer Trends, EIOPA-CCPFI-11/023., Annex 12.

⁸³ High Court rulings related to insurance issues are very rare in Finland. In 2010, the Finnish High Court gave a ruling in a case where a foreign EEA-life insurer gave misleading information on the costs structure of the product.

protection, a lack of action at EU level will likely result in an increase in the number of cases of mis-selling of insurance products and cases where consumers are led to take undue risks.⁸⁴

An unlevel playing field develops between product issuers

A regulatory patchwork can lead to increased administrative costs and regulatory arbitrage. Different levels of regulatory requirements can create an incentive for products to be structured and marketed to take advantage of less onerous requirements. Product proliferation has been indicated by some stakeholders as providing prima facie evidence of regulatory arbitrage. In practice, however, it is difficult to assess the extent to which differences in transparency requirements, as such, are a sufficient motivation for driving market entry or exit. In relation to administrative costs, a number of consultation respondents commented that duplication, overlaps in requirements or differences in requirements both sectorally and between Member States (where they operate cross-border) could potentially raise their administrative costs. They noted that a lack of clarity as to the content of regulatory requirements and associated liabilities could also lead to greater compliance costs for firms (for instance, through the need to purchase legal advice).

Increased barriers to the further development of the single market

Most insurance products are currently not sold cross-border in great volumes; only about 5%, unlike UCITS products. The regulatory patchwork of sales requirements constitutes a barrier to further cross-border business across different product types. The impact of national differences in sales rules was strongly highlighted by UCITS stakeholders (prior to the development of the KIID⁸⁵), who identified such differences as a key barrier to further development of cross-border efficiencies.

The failure to effectively mitigate asymmetries of information about different sales practices at EU level has encouraged action at the national level to address emerging problems, and the financial crisis has led to such action being more likely in the absence of further steps at EU level. Such action at national level is necessarily uncoordinated, leading to increased differences in approach across Member States.

In addition, given the ongoing PRIPs initiative, Member States will have to address disclosure requirements in the light of the new PRIPs standard, but without harmonized sales rules for these products the effect on consumers will be different in different Member States.

4.2. The EU's right to act

The legal basis for EU action in insurance is the Treaty provisions related to free provision of services. According to Article 3 of the EU Treaty, the EU pursues the objective of an Internal Market characterised by the free movement of goods, persons, services, and capital. Article 26 of the Treaty of the Functioning of the European Union (TFEU) further states that the Internal Market shall constitute an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the TFEU Treaty.

⁸⁴

http://ec.europa.eu/consumers/rights/docs/investment_advice_study_en.pdf

⁸⁵

Key investor information document, <http://www.pwc.lu/en/ucits4/docs/pwc-flyer-kiid.pdf>

Any follow-up action needs to be based on Article 53 (2) TFEU which is the legal basis to adopt EU measures aimed at promoting an internal market in financial services. Article 169 TFEU states that the EU measures taken in order to complete the Internal Market should have as part of the objective of protecting the interests of consumers. The Charter of Fundamental Rights of the EU also states in Article 38 that the Union shall ensure a high level of consumer protection.⁸⁶

Although action at Member State level could in principle contribute to addressing some aspects of the problems that have been identified in the IMD, it would not be enough to complete the objectives.

General insurance

In their analysis of the 2007 CEIOPS survey, supervisors indicated that there was a need for clarification of some terminology used in IMD1 and in addition, that some of IMD1's requirements are impractical from the point of view of day-to-day supervision; therefore an amendment of IMD1 is necessary.

Insurance PRIPs (unit-linked life insurance products)

Several supervisors (DE, FR, HU) reported in their annual report that the problems related to unit-linked insurance products deserved special attention. In particular, the German, the French and Hungarian supervisors identified as a practice adversely impacting consumers that certain insurers delay the fulfilment of customer orders regarding asset funds if the issuer suspends the sale of underlying assets. In the course of 2009, 2010 and 2011, those supervisors addressed an appeal to insurers distributing unit-linked life insurance products providing guidance on acceptable practices.⁸⁷ For instance, to address this issue, the Hungarian FSA (HFSA) established concept-level guidelines on further developing the total cost indicator (TCI) of unit-linked life insurance products. As a conclusion, it has been suggested that different regulatory approaches at EU level will lead to unlevel market regulation.

In particular, 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 (aligning IMD with MiFID rules on sales of insurance policies with investment elements). Only EU action can ensure that all policyholders and beneficiaries under insurance policies in

⁸⁶ In its decision, dated 4 December 1986 (Case 205/84), the European Court of Justice gave four reasons why insurance policyholders need special protection:

- (1) Insurance is a highly particular service because it is linked to future events, the occurrence of which is uncertain at the time a contract is concluded;
- (2) An insured person may find himself in a very precarious position if he does not obtain payment after filing a claim for compensation;
- (3) It is very difficult for a person seeking insurance to assess the terms of a contract and the outlook for the insurer's future financial position;
- (4) Insofar as insurance has become a mass phenomenon, it is just as essential to protect the interests of third parties.

⁸⁷ ACP Annual report 2010: <http://www.banque-france.fr/acp/publications/rapports-annuels/2010-annual-report-acp.pdf>; The HFSA's Financial Consumer Risk Report http://www.pszaf.hu/data/cms2325056/CP_riskreport_2011H1.pdf and BaFin report: http://www.bafin.de/clin_117/nn_720620/SharedDocs/Downloads/EN/Service/Jahresberichte/2009/annualreport_09__complete,templateId=raw,property=publicationFile.pdf/annualreport_09__complete.pdf

the EU benefit from equal and comprehensive protection. This EU action also aims to ensure a level playing field and to promote further integration within the Internal Market.

It follows that, in accordance with the principles of subsidiarity and proportionality as set out in Article 5 TEU, the objectives of the proposed action cannot be sufficiently achieved by Member States and can therefore be better achieved at EU level.

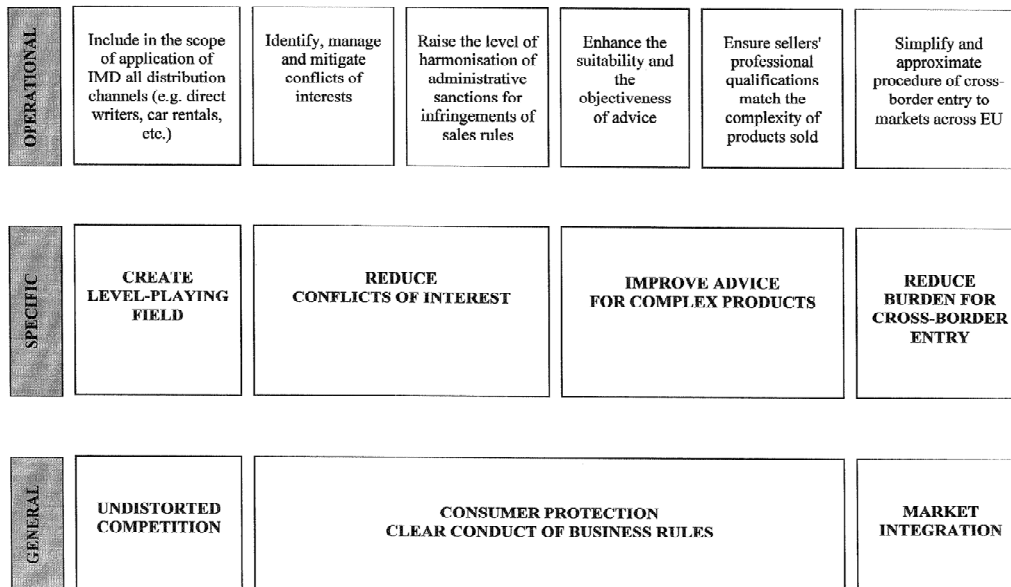
Alternative legislative solutions and soft law approaches have been examined and dismissed

In its advice EIOPA examined other legislative solutions, such as the possibility of making the provisions in the Luxembourg Protocol legally binding instead of modifying IMD1. However, without prejudice to the possibility of incorporating some of the guidance in the Luxembourg Protocol into IMD2, some Members have expressed concern about the feasibility of the Luxembourg Protocol becoming a legally binding EU instrument. Moreover, consideration should be given to how its implementation would be enforced. A different approach to a classical directive is a “multi-level structure”; that is, the adoption of high-level rules, plus more detailed rules. The majority of Member States favoured this approach which retains the conventional structure of the IMD, but adopts more detailed requirements (possibly in the form of regulatory technical standards or implementing technical standards) in limited areas. Such an alternative could be complemented by amending or incorporating provisions of the Luxembourg Protocol.

5. OBJECTIVES

The revision of IMD1 has three sets of objectives: general, specific and operational. The general objectives are the overall goals of the project: consumer protection; undistorted competition; market integration. The specific objectives are the immediate goals of IMD2, the targets that first need to be reached in order for the general objectives to be met: create a level playing field; reduce conflicts of interest; improve advice for complex products; reduce the burden for cross-border entry. The operational objectives are the deliverables that the IMD2 project should produce: expand the scope of application of IMD to all distribution channels (e.g. direct writers, car rental firms, etc.); identify, manage and mitigate conflicts of interest; raise the level of harmonisation of administrative sanctions for infringements of sales rules; enhance the suitability and the objectiveness of advice; ensure sellers' professional qualifications match the complexity of products sold; simplify and approximate the procedure for cross-border entry to markets across the EU (See the objective tree below).

OBJECTIVES TREE



5.1. Consistency of the objectives with other EU policies

The identified objectives are coherent with the EU's fundamental goals of promoting the harmonious and sustainable development of economic activities, a high degree of competitiveness, and a high level of consumer protection, which includes the safety and economic interests of citizens (Article 169 TFEU). These objectives are also consistent with the reform programme proposed by the European Commission in its Communication *Driving European Recovery*,⁸⁸ the 'Europe 2020 strategy' for smart, sustainable and inclusive growth,⁸⁹ the ongoing MiFID review and the PRIPs initiative.

5.2. Consistency of the objectives with fundamental rights

The legislative measures setting out conduct of business rules for all sellers of insurance products, including sanctions, will be in compliance with relevant fundamental rights and particular attention will be given to the necessity and proportionality of the legislative measures. The following fundamental rights of the Charter of Fundamental Rights of the European Union are of particular relevance: freedom to conduct a business (Art. 16) and consumer protection (Art. 38). Limitations on these rights and freedoms are allowed under the Charter. The objectives as defined above are consistent with the EU's obligations to respect fundamental rights. However, any limitation on the exercise of these rights and freedoms must be provided for by the law and respect the essence of these rights and

⁸⁸ Communication for the spring European Council, Driving European recovery, COM (2009)114

⁸⁹ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:2020:FIN:EN:PDF> and http://ec.europa.eu/commission_2010-2014/barnier/headlines/news/2012/02/20120227_en.htm

freedoms⁹⁰. Subject to the principle of proportionality, limitations may be made only if they are necessary and genuinely meet the objectives of general interest recognised by the Union or the need to protect the rights and freedoms of others.

6. POLICY OPTIONS

6.1. Proposed legislative structure of IMD2 and involvement of EIOPA

Any new measures to be proposed within the current revision would follow the 'classical directive' approach, as is already the case with IMD1. Therefore, policyholders and beneficiaries would benefit from a higher level of protection for general insurance and for insurance PRIPs products. The so-called 'multilevel' approach (see annex 6 and annex 11) would be applied to the chapter dealing with distribution of insurance PRIPs, in order to be in line with the structure of the relevant provisions in MiFID⁹¹. Alternative legislative solutions and soft law approaches have been examined and dismissed (see section 4.2.).

6.2. Identification of options

The problems described above require different levels of regulatory solutions, as indicated in the table below.

The options highlighted in bold are the Commission Services' preferred options.

The options chosen for general insurance products apply also to insurance PRIPs. The options chosen only for PRIPs are additional because of the specific investment features of the products (see the further explanation in 2.4).

Problems	Objectives addressed	Policy options
1 Scope of IMD2	Consumer protection Undistorted competition Market	0 – Take no action (apply IMD1 to agents, brokers) 1 – Combine current IMD scope with a 'Soft law' approach (issuing guidelines, self-regulation, ethical codes, etc.) - recommend to apply some provisions of IMD1 to all sellers of insurance products

⁹⁰ The new rules on sanctions could have an impact on fundamental rights. Options interfere with Articles 7 and 8 and potentially also with Articles 47 and 48 of the EU Charter on Fundamental Rights. The indicated policy options (1 and 2) on sanctions provide for limitation of these rights in law while respecting the essence of these rights. Limiting these rights is necessary to meet the general interest objective of ensuring compliance with IMD rules. In order to be lawful the administrative measures and sanctions which are imposed must be proportionate to the breach of the offence, respect the right not to be tried or punished twice for the same offence, the presumption of innocence, the right of defence, and the right to an effective remedy and fair trial in all circumstances (i.e. proportionality is taken into account when the preferred option was chosen).

⁹¹ The majority of EIOPA Members and majority of stakeholders (consumer organisations, regulators, supervisors, insurance intermediaries, and insurance industry) were not in favour of adopting a Lamfalussy Structure and prefer retaining the Classical Directive structure of the IMD (single tier). Whilst most EIOPA Members supported the possible adoption of a multi-level structure as an alternative solution to keeping the directive as a classical directive, some examples of eligible areas for a "multi-level" approach either as regulatory technical standards or implementing technical standards by EIOPA were the following: Professional requirements, Information requirements; Remuneration disclosure; Conflicts of interest.

	integration	<p>2 – Extend the scope only to direct writers (so that it would cover agents, brokers, direct writers)</p> <p>3 – Extend the scope to all sellers of insurance products (so that it would cover direct writers, agents, brokers, travel agents, car rental firms, suppliers of goods (B2B + B2C)).</p> <p>4 – Extend the scope to all sellers of insurance products except for:</p> <ul style="list-style-type: none"> • sales of insurance complementary to the supply of goods (seller's side); and • large risks/professionals (buyer's side) <p>(so that it would cover direct writers, agents, brokers, travel agents, car rental companies, suppliers of goods not meeting conditions for exemption from the scope (B2C only).)</p> <p>5 – Extend the scope to:</p> <p>- all sellers of insurance products except for:</p> <ul style="list-style-type: none"> • sales of insurance complementary to the supply of goods (seller's side); and • large risks/professionals (buyer's side) <p>- and to after-sales activities</p> <p>(so that it would cover direct writers, agents, brokers, travel agents, car rentals, suppliers of goods not meeting conditions for the exemption, loss adjusters, claim handlers (B2C only))</p> <p>but with a lighter "ancillary"/after-sales regime in the interests of proportionality, as described in the table below.</p> <p>[Options are mutually exclusive]</p>	
<p>2 Conflicts of interests at the point of sale: remuneration structure and links between direct writer and intermediary</p>	<p>Consumer protection</p> <p>Undistorted competition</p> <p>Market integration</p>	<p><u>General insurance</u></p> <p>0 – Take no action</p> <p>1 – Introduction of</p> <p>(a) a European Standard for status information ("business card solution") and</p> <p>(b) disclosure of nature, structure and amount of remuneration (mandatory or on request) for all products (and transitional period)</p> <p>2 – Ban on commissions (complete , not only for "independent advice")</p> <p>3 – Soft law (issuing guidelines, self-regulation, ethical codes, etc.)</p> <p>[Options 1 and 3 are not mutually exclusive]</p>	<p><u>Insurance PRIPs – (life insurances with investment elements)</u></p> <p>0 – Take no action (apply the same rules as for general insurance)</p> <p>1 - Apply revised MiFID entirely, conduct of business rules and organisational requirements (risk management, internal audit, etc.) (MiFID Level 1 and 2)</p> <p>2 – Introduction of a revised MiFID-like regime based only on the conduct of business rules (identify, manage and mitigate all conflicts of interest through ban on commissions (complete or only for "independent advice"), (Article 23-of MiFID II) Level 2 guidelines by ESMA/EIOPA</p> <p>3. Soft law (issuing guidelines.</p>

			self-regulation, ethical codes, etc.) 4. Prohibition of products difficult to understand even for professional market participants [Options are not mutually exclusive]
<p>3 Advice by sellers of insurance policies is biased due to conflicts of interest, or of an insufficient quality</p> <p>A/inappropriate/biased advice</p> <p>B/low quality advice - professional requirements</p>	<p>Consumer protection</p> <p>Undistorted competition</p> <p>Market integration</p>	<p>A</p> <p>0 – Take no action</p> <p>1 – Introduce a suitability test as part of the advice process for all insurance products</p> <p>2 – Clarify the scope of “insurance advice” by use of a definition - the intermediary or employee of an insurance undertaking, on the basis of the information provided by the customer, provides a recommendation on whether an insurance product(s) fits the demands and the needs of that customer.</p> <p>3 – Ban on commission from independent advice (Art 24. MiFID)</p> <p>[Options are not mutually exclusive]</p>	<p>A</p> <p>0 – Take no action (,apply the same rules as for general insurance</p> <p>1 – Introduce a suitability test as part of the advice process for life insurances with investment elements (incl. PRIPs) detailed suitability test (Level 2) (based on article 25 MiFID II)</p> <p>2– Ban on commission from independent advice (Art 24. MiFID)</p> <p>[Options are not mutually exclusive]</p>
		<p>B</p> <p>0 – Take no action</p> <p>1 – Ensure that professional qualifications are proportionate to the complexity of the products sold (guidelines to be drafted at Level 2)</p> <p>2 – Full harmonisation of requirements for professional qualifications</p> <p>3 - Soft law (issuing guidelines, self-regulation, ethical codes, etc.)</p> <p>[Options 1 and 3 are not mutually exclusive]</p>	<p>B</p> <p>0 – Take no action (apply the same rules as for general insurance) which means that professional qualifications are proportionate to the complexity of the products sold (guidelines to be drafted at Level 2).</p> <p>1 – Full harmonisation of requirements for professional qualifications</p> <p>[Options are mutually exclusive]</p>
<p>4 Burdensome for insurance intermediaries and direct writers to enter markets on cross-border basis</p>	<p>Undistorted competition</p> <p>Market integration</p> <p>Consumer protection</p>	<p>0 – Take no action</p> <p>1 – Revise "general good" rules</p> <p>2 – Introduce provisions relating to freedom to provide services (FOS) and freedom of establishment (FOE) definitions and a mutual recognition system as well as a simpler notification process (to provide greater detail and clarity).</p> <p>3 – Introduce a centralised registration system by EIOPA</p>	

		4 – Soft law (issuing guidelines, self-regulation, ethical codes, etc.) [Options are not mutually exclusive]
5 Lack of effective sanctions	Consumer protection Undistorted competition Market integration	0 – Take no action 1 – Introduce a general framework for sanctions and enhanced harmonisation of sanctioning powers (guidelines to be drafted at Level 2) 2 – Introduce fully harmonised sanctions regime by unifying sanctioning powers and enforcement rules 3– Soft law (issuing guidelines, self-regulation, ethical codes, etc.) [Options are mutually exclusive]

Description of policy options

1.Scope of initiative

Option (0) means that only agents and brokers remain to be covered by IMD2. Option (1) would combine the scope of IMD1 with a 'soft law' approach (issuing guidelines, self-regulation, ethical codes, etc.). This means that the Commission would recommend applying non-binding high level, minimalist conduct of business rules (such as professional requirements and information requirements) to other market players (such as direct writers, travel agents and car rental companies). Option (2) would extend the scope only to direct writers, but this would leave other sellers of insurance products out of the scope. This option would ensure that insurance companies selling directly to consumers would be brought within the scope of the new Directive on similar grounds as insurance agents and brokers. Option (3) would extend the scope to all sellers of insurance products. This would include direct writers but also other market participants who sell insurance products on an ancillary basis (travel agents and car rental companies, suppliers of goods not meeting conditions for the exemption – declaration requirements should apply to them). Option (4) would extend the scope as in solution (3) but, at the same time, allow exemptions as follows: **a)** full exemption: the activity is a sale complementary to the supply of goods (such as glasses or mobile phones):⁹² as in IMD1 but €500 would be indexed to €600 (reflecting an increase which has already been implemented by Member States in compliance with provisions contained in IMD1) or **b)** exemption from the disclosure rules only: the buyer concludes contracts of large risks insurances (such as insurance for a private jet) or the buyer is a professional client (rather than a retail client). Large risks are defined by Article 13 (27) of the Solvency II Directive. This means that the IMD would be applicable only in B2C relationships. Option (5) would extend the scope as in solution (4) and would also require after-sales players to notify the competent authorities (through a simplified declaration procedure) and to disclose their business status (European business card solution) to the consumers.

A declaration procedure means

⁹² See more explanation in Annex 17. (flowchart)

a lighter regime which would be introduced for market players which sell insurance products on an ancillary basis (e.g. car rental companies, travel agents, suppliers of goods not meeting conditions for the exemption)

They should apply similar conduct of business rules and comply with some basic professional qualifications.

The same lighter regime would apply for loss adjusters and claims handlers.

The lighter regime would consist of a simplified procedure based on a declaration submitted by the relevant market participant to the competent authorities instead of a standard registration. If Member States deem it necessary for consumer protection purposes they may decide to use the standard registration regime instead of the light regime (declaration procedure).

2. Conflicts of interest

General insurance and insurance PRIPs

Option (0) means that only low level conflicts of interest rules would be applied (Article 12 of IMD1). Article 12 of IMD1 already addresses the issue of “conflict of interest”, though not using the term. It requires intermediaries, on a contract-by-contract basis, to inform the customer whether they are giving advice based upon a fair analysis, or whether they have contractual obligations with one or more insurers. In addition, the intermediary has to state in writing the reasons for any advice on a given insurance product and all this is supervised and controlled by the national supervisory authorities.

Option (1) introduces a mandatory standardised business card (European Business Card).

European Business Card solution means

Providing information on an A4 page, so-called "business card" to the consumer at the pre-contractual stage. It would show:

the relationship between the insurance company and the seller,

the nature of the remuneration (a fee, commission or salary),

its structure (whether financed directly by the client or an undertaking),

the amount of the remuneration,

and what it includes in terms of services: claims handling, advice, administration, etc.

This option introduces a remuneration disclosure. The insurance intermediaries would disclose in advance their remuneration to the customer (fee or commission). The insurance undertakings engaged in a direct sale should disclose the variable remunerations of their employees linked to the sale. Mandatory disclosure of remuneration means that the intermediary should disclose his remuneration towards the customer. On request regime means that the intermediary need only disclose his remuneration if a customer specifically requests the disclosure. The transitional

period means that a mandatory 'full disclosure' regime is envisaged for the sale of life insurance products and an 'on-request' regime (i.e. on customer's demand) for the sale of non-life products with transitional period of 3 years. After the expiry of 3 years transitional period, the full disclosure regime will automatically apply for the sale of non-life products as well. Option (2) would completely ban commissions and introduce a fee-based system (i.e. clients pay for advice). Option (3) would combine the current IMD scope with a 'soft law' approach. This means that the Commission would only recommend applying non-binding conflict of interests rules. Actions should be taken by insurance companies and sellers voluntarily to refrain from business conduct that is misleading (such as setting up ethical codes, etc.).

Additional rules for insurance PRIPs

Option (0) would mean that the same rules set for the sales of general insurance would apply to insurance PRIPs (European business card system and disclosure for remuneration). Option (1) would apply MiFID entirely – organisational requirements (risk management, internal audit, etc.) as well as conduct of business rules (obligation to identify, manage and mitigate all conflicts of interest). The customer would be given information both about the product's insurance cover and the investment risks related to it. Detailed requirements on conduct of business rules would be set by EIOPA at Level 2. Option (2) would only apply MiFID-based conduct of business rules (see above) and not apply its rules for organisational requirements. In view of that, EIOPA in collaboration with ESMA⁹³ could be asked to develop guidelines for the application of IMD2 rules on the sale of insurance PRIPs in order to ensure consistency with MiFID Level 2 work.

Level 2 guidelines mean that EIOPA will have to draft five regulatory technical standards regarding

- 1) the content of adequate professional knowledge and ability of the intermediary;
- 2) mutual recognition of the intermediary's professional qualifications;
- 3) conflicts of interests linked to the sale of insurance investment products,

In relation to the conflicts of interests linked to the sale of insurance investment products, EIOPA will have to draft regulatory standards on defining steps that may be required to identify, prevent, manage and disclose such conflicts; and establishing criteria for specifying types of conflicts which may damage the interests of customers.

- 4) general principles and information to customers in relation to the sale of insurance investment products;

As regards general principles and information to customers in relation to the sale of insurance investment products, the regulatory standards are to ensure that insurance intermediaries comply with the following principles: 1) they act honestly fairly and professionally in accordance with the best interests of customers; 2) they ensure that information given to customers is fair, clear and not misleading;

This means that EIOPA will have to draft regulatory standards how insurance intermediaries should provide information about their identity, the insurance undertaking and their services, in particular whether advice is provided on an independent basis, about the scope of any market analysis, about proposed products and investment strategies, and about costs

⁹³

ESMA - European Securities and Markets Authority, www.esma.europa.eu.

5) detailed suitability and appropriateness test for the sale of insurance investment products.

EIOPA also will have to draft regulatory standards how suitability and appropriateness is to be assessed and required information to be obtained from the customer.

More detail on Level 2 measures and specific task given to EIOPA can be found in Annex 19.

Under Option (3), market players would be encouraged to set up ethical codes when selling such products. Option (4) would prohibit products that are difficult to understand even for professional market participants. Option (4) would completely ban all PRIPs insurances and require them to be withdrawn from the market.

3. Biased and low-quality insurance advice

Section A: Inappropriate or biased advice stemming from conflicts of interest or improper assessment of buyer's needs

General insurance and PRIPs insurance

Option (0) covers all advice given for the purpose of assisting the customer in concluding an insurance contract or with a view to the management or implementation of an insurance contract. There is no definition of advice under IMD1. The “advice” is part of the sales discussion for an insurance product, where the seller analyses the consumer’s needs and tests the appropriateness of the recommended insurance product to the customer's needs. Option (1) would introduce a *detailed suitability test* for sales of all insurance products when there is a sale with advice. Selling without advice would require an *appropriateness test* for those products where the underlying investment funds are composed of complex products (as in MiFID). This suggested regime would apply MiFID rules, and detailed suitability rules would be drafted at Level 2.

An *appropriateness test* means that the seller must request information from the client regarding his knowledge and experience to enable the firm to assess whether the insurance investment product is appropriate for the client. When advice is provided, the seller has to apply a *suitability test*, which is broader than the appropriateness test, in that the seller must also obtain information regarding the financial situation and investment objectives of the client.

Option (2) would introduce a definition of insurance advice along the lines of the provision of personal recommendations to a customer, either upon his request or at the initiative of the insurance undertaking or the insurance intermediary. Option (3) would mean that the seller of insurance products would not be able to accept any payment provided by any third party if he wanted to provide the client with independent advice. Independent advice in this case would mean that the seller covers a sufficiently large number of products and cannot receive any benefit from an insurance company (therefore the consumer should pay a fee for the advice). This option would thus introduce a form of advice aiming at a higher guarantee of independence and market participants could choose whether they want to buy a product with "independent advice" or with "advice" which is not claimed to be fully independent. The obligations under this option would apply only to those sellers who claim to provide "independent advice".

Additional rules for insurance PRIPs only

Option (0) would mean that the rules for the sales of general insurance would apply to insurance PRIPs as well (i.e. insurance advice is defined). Option (1) would introduce suitability and appropriateness tests for the sales of insurance PRIPs only (see Option (2) above for general insurance). This suggested regime proposes introducing a requirement to provide the consumer with an advice based on a suitability test assessing his needs, demands and his financial situation and is based on the example of MiFID. Providing such advice would depend on the consumer duly informing the seller about his profile. Option (2) introduces a ban on commission for independent advice (as under Option (3) for general insurance).

Section B: Low quality advice stemming from the seller's insufficient level of knowledge and professional qualifications

General insurance and insurance PRIPs

Option (0) would mean that high level professional requirements would remain (Article 4 of IMD1).

Option (1) would mean the introduction of high-level principles which give Member States the possibility to graduate the knowledge and ability requirements according to the activity pursued or type of intermediary. At the same time, this would ensure that professional qualifications are proportionate to the complexity of the products sold. This means a three-level system would be introduced: a) lower level requirements for ancillary sellers of simpler products (e.g. travel insurances); b) regular level requirements for sellers of general insurance products (non-life and pure life products); c) higher level requirements for sellers of complex products (insurance PRIPs such as unit linked life insurance policies). There would also be a mutual recognition of intermediaries' knowledge and abilities and recognition of foreign proof of professional qualifications. Option (2) would mean that a common knowledge and skills requirement system would need to be set up at EU level and all sellers would have to follow the same training irrespective of the method of distribution or the complexity of product they offer. Option (3) would encourage insurance companies and intermediaries to cooperate in the application of professional requirements (organising training, exams, etc.) and set up ethical codes.

Additional rules for insurance PRIPs

Option (0) would mean that the same rules set for the sales of general insurance would apply to insurance PRIPs (see above). Option (1) would mean a common system of knowledge and skills requirements at EU level (see Option (2) above for general insurance).

4. Cross-border business

Option (0) would mean that the current, high level principles regulating cross-border business (Article 6) and non-binding EIOPA Luxembourg Protocol would continue. Option (1) would mean that the Commission would revise its Interpretative Communication (2000/C 43/03) on 'Freedom to provide services and the general good in the insurance sector' to list exhaustively the exceptions under 'general good' that can be invoked by Member States. The concept of "general good" means that if a registered insurance intermediary intends to carry on business in another Member

State, he must comply with the conditions under which, for reasons of the general good, such business must be conducted in the host Member State. Option (2) would incorporate definitions already existing in the Luxembourg Protocol in the IMD and introduce a simpler notification process for intermediaries going cross-border. This option would clarify the application of the Treaty principles regarding the FOE and the FOS and introduce some enforcement rules linked to those freedoms, based on the MiFID II. Option (3) would introduce a centralised registration system that would work as follows: each Home State website would be required to publish a list of intermediaries passporting into other Member States containing the following data: (i) name, address and registration number of intermediary; (ii) type of intermediary (e.g. tied, independent); (iii) classes of business (life/non-life) to be undertaken; (iv) Member States in which the intermediary intends to operate; and (v) whether activities would be on a FOS or FOE basis. These lists would be required to be accessible in the language of the home Member State and in a common language (e.g. English). A hyperlink to the relevant web address for each list would be required to be forwarded to EIOPA and similarly published on its website (in the public area). Option (4) means that the Luxembourg Protocol would be incorporated in the text as a non-binding legislative tool.

5. Sanctions

Option (0) means that only high level principles on sanctions would remain (Article 8 of IMD1). Option (1) would introduce minimum common rules on sanctions, leaving Member States with the possibility of establishing stricter rules. Those common rules would include the requirement that the maximum level of administrative fines in national legislation is not lower than a common EU level. Option (2) envisages common rules on the sanctions to be established, including the setting of minimum and maximum levels of fines. Under this option, Member States would be prevented from setting minimum or maximum levels lower than those established at EU level and the sanctioning powers of supervisory authorities would be harmonised fully (*see more details in Annex 4*).

7. ANALYSIS OF IMPACTS AND COMPARING THE OPTIONS

The options are assessed against the general objectives of the project (in the following order):

Objective 1: Consumer protection and clear conduct of business rules (Obj. 1)

Objective 2: Undistorted competition (Obj. 2)

Objective 3: Market integration (Obj. 3)

7.1. Extension of the scope

Issue 1: Scope	Effectiveness (benefits)			Cost effective ness
	Consumer protection and clear conduct of business rules (Obj.1.)	Undistorted competition (Obj.2.)	Market integration (Obj.3.)	

0 – Take no action (Baseline scenario)	0	0	0	N/A
1 – Combine current IMD scope with a 'Soft law' approach (issuing guidelines, self-regulation, ethical codes, etc.) - recommend to apply some provisions of IMD1 to all sellers of insurance products	0	0	0	0
2 – Extend the scope only to direct writers so that it would cover agents, brokers direct writers	+	+	+	~/-
3 – Extend the scope to all sellers of insurance products (so that it would cover direct writers, agents, brokers, travel agents, car rental firms, suppliers of goods (B2B + B2C)).	++	++	+	--
4 – Extend the scope to all sellers of insurance products except for: <ul style="list-style-type: none"> • sales of insurance complementary to the supply of goods (seller's side); and • large risks/professionals (buyer's side) (so that it would cover direct writers, agents, brokers, travel agents, car rental companies, suppliers of goods not meeting conditions for the exemption (B2C only)).	++	++	+	~/-
5 – Extend the scope to: - all sellers of insurance products except for: <ul style="list-style-type: none"> • sales of insurance complementary to the supply of goods (seller's side); and • large risks/professionals (buyer's side) - and to after-sales providers (so that it would cover direct writers, agents, brokers, travel agents, car rentals, suppliers of goods not meeting conditions for the exemption, loss adjusters, claim handlers (B2C only)) but with a lighter "ancillary"/after-sales regime in the interests of proportionality.	+++	+++	+++	~/-

Stakeholders' view: The vast majority of stakeholders (intermediaries, industry, consumers) supported Option (5) in order to level the playing field. Travel agents and car rental companies agreed provided a lighter regime (declaration procedure) was applied to them. Moreover, a majority of stakeholders (consumer organisations, regulators, supervisors, investment firms and the insurance industry) supported the approach of raising standards for the sale of investment based insurance products (insurance PRIPs). It was suggested that two sets of rules could be applied: one for the sales of general insurance products and the other for the sale of life insurance

products with investment elements (because those products are substitutable with investment products).

Under the **baseline scenario**, the current scope would remain. As regards consumer protection and clear conduct of business rules (obj. 1), **Option (1)** would not provide an effective solution. In the area of financial services, soft law has been proven ineffective as studies show that recommendations addressed to Member States who would like to coordinate their national regulations would not work in practice due to the non-binding character of the measures⁹⁴. Regarding the objective of undistorted competition and market integration (obj. 2&3), this option has proven ineffective as the unlevel playing field remains because non-binding rules cannot be enforced.

As regards consumer protection (obj.1), **Option (2)** would provide consumers with more consistent information regardless of the channel used. As for market players, a slight increase in costs can be expected as insurance undertakings already fulfil similar requirements in terms of professionalism, good repute and disclosure. This option is more beneficial in reaching the objective of undistorted competition than Option (1) (obj. 2), as consumers can expect benefits related to increased market competition. A level playing field would be achieved between intermediaries and direct writers. As for market integration (obj.3.), this option would mitigate regulatory arbitrage between different markets in the EU (see the opinion of insurance intermediaries at the public consultation), but no significant structural changes to any markets would be expected to result from the extension of articles 12 and 13 of IMD1 to direct writers.

As regards consumer protection (obj.1.), **Option (3)** could be effective as it would ensure that consumers would receive the same information regardless of the distribution channel used and the wider scope could allow for better regulatory coherence for market players. As for undistorted competition (obj. 2.), this would be more effective than Option (2) and would achieve a complete level playing field between all sellers of insurance products. This option is also beneficial to achieve market integration (obj.3.), as uniform requirements in all Member States would provide legal certainty for all market participants and also facilitate the procedures of competent authorities. This would mitigate regulatory arbitrage between different markets in the EU.

Option (4) would be less effective in achieving better consumer protection and clearer conduct of business rules (obj. 1.), than Option (3) as the only products that are not covered by this option are simple, very cheap products that cannot create consumer detriment. It has been proven (see the results of the public consultation) that some market players do not need protection: purchasers of large risks and professional purchasers are in general large firms with their own insurance and legal staff who manage their insurance needs and interact with insurance intermediaries at a professional level. The key benefits for the achievement of undistorted competition (obj. 2.), relate to the fact that most of the sales channels and products are covered, so it is only marginally less effective than option (3) for consumers. As for market integration, this option would mitigate regulatory arbitrage and enhance cross-border business (see the opinion of intermediaries in the public consultation).

⁹⁴ Impact assessment of the Regulation on access to basic banking services, http://ec.europa.eu/internal_market/finservices-retail/docs/inclusion/sec_2011_906_en.pdf

In line with the principle of proportionality, **Option (5)** would bring, in general, key benefits. These benefits relate to the fact that the impact of most provisions would be targeted on those sales of products and services that are most relevant so it would only be marginally less effective than option (3) and more proportionate than Option (4) in achieving enhanced consumer protection (obj.1.). To achieve undistorted competition (obj.2.), this would mean that most of the *sales channels, after-sales services and products* are covered, so it would only be marginally less effective than Option (3), and more proportionate than Option (4). This would create a level playing field for all players in the insurance value chain. Proportionality would be ensured for after-sales players and ancillary providers: only a simple declaration of their existence, status information disclosure, basic professional standards and good repute would be required. To achieve market integration (obj.3.), this would be at least as effective as Option (4) but more consumer confidence in registered after-sales players can be expected. This would also enhance cross-border business for after-sales players (claim handlers, loss adjusters).

Proportionate approach to preferred policy options in problem 1 (explanatory table)

Organisational rules	
Registration requirements	
FULL	Intermediaries (agents, brokers) Direct writers (<i>under Solvency II</i>)
PARTIAL (declaration)	Ancillary service provider (car rental firms, travel agents, suppliers of goods not meeting conditions for the exemption) After sales (loss adjusters, claim handlers)
NONE	Sales of insurance complementary to the supply of goods (ancillary+ below €600)

Compliance cost implications

Option (1) would involve slight costs. As for Option (2), total compliance costs should be low, as insurance undertakings already fulfil similar requirements in terms of professionalism, good repute and disclosure. Direct writers would have to bear the cost of additional regulation. **Option (2)** would entail an average cost of €40,000 (one off costs)/ €10,000 (recurring costs) per direct writer (4618 companies, out of which SMEs: none; total costs around €185,000,000 one-off, €46,180,000 ongoing). This total compliance cost estimate covers training costs, costs related to information requirements, IT, administration costs, etc. (all figures are based on Eurobarometer data, revised PwC study figures and Commission Services' analysis).

As far as the total compliance costs of **Option (3)** are concerned, the following costs estimates have been established (all figures are based on Eurobarometer data, revised PwC study figures and Commission Services' own analysis):

Direct writers (per company): €40,000 (one off costs)/ €10,000 (recurring costs) (4618 undertakings in the EU, out of which SMEs: none) (same cost estimates as for Option (2)).

Travel agents (per company): average costs estimates: €500 (one off costs)/ €50 (recurring costs). (68 000 undertakings in the EU, out of which SMEs: 80%), (total costs around €34,000,000 one-off, €3,400,000 ongoing).

Car rental companies (per company): average costs estimates: €600 (one off costs)/ €50 (recurring costs) (30 976 undertakings in the EU, out of which SMEs: 80%), (total costs around €18,585,600 one-off, €1,548,800 ongoing).

These total compliance cost estimates cover training costs, costs related to information requirements, IT, administration costs, etc. Direct writers bear relatively higher cost compared to other market players because they are the product manufacturers and their IT system needs to be substantially adjusted to comply with new requirements.

Option (4) would lessen the costs of Option (3) to €25,000,000 (Commission services' estimates) as it excludes sellers of insurances which are complementary (ancillary) to the supply of some goods. A good example is an optician who sells complementary insurance on glasses. It is estimated that 200,000 market players (such as opticians) sell insurance complementary to the supply of goods (in this case insurance on glasses). It is also estimated that the total compliance costs will be a maximum of €125 per entity (one-off cost). This will cover training costs, costs related to information requirements, IT, administration costs, etc. Those ancillary sellers (whose main business is not selling insurance products) bear low cost compared to other market players because they sell inexpensive, simple product and their IT system do not need to be substantially adjusted to comply with new requirements. **Option (5):** Total compliance costs for direct writers, agents, brokers, travel agents, car rentals would be the same as in Options (3) or (4). For loss adjusters, this would mean €400 (one off costs)/ €50 (recurring costs)/company and for claims handlers €400 (one off costs)/ €50 (recurring costs)/company (all figures are based on Commission Services' best estimates). Total number of loss adjusters is 6000 in the EU. Total costs are around €2,400,000 one-off, €300,000 ongoing costs.

Overall assessment: The preferred option is Option (5) because it addresses consumer protection concerns with a proportional approach in respect of after-sales services and ancillary insurance providers.

7.2. Conflicts of interests

Issue 2. Conflicts of interests	Effectiveness (benefits)			Cost effectiveness
	Consumer protection and clear conduct of business rules (Obj.1.)	Undistorted competition (Obj.2.)	Market integration (Obj.3.)	
0 – Take no action (Baseline scenario)	0	0	0	N/A
1.A – Introduction of a European Standard for status information ("business card solution") for all products and full disclosure of remuneration ⁹⁵ Mandatory full disclosure	++	--	+	+
1.B – Introduction of a European Standard for status information ("business card	+	-	+	++

⁹⁵

This option is a compromised suggestion by key stakeholders and EIOPA.

solution") for all products and full disclosure of remuneration ⁹⁶ On request disclosure				
2 – Ban on commissions	--	--	--	--
3 – Soft law (issuing guidelines, self-regulation, ethical codes, etc.)	--	--	0	0

Stakeholders' view: The vast majority of stakeholders supported the business card solution: intermediaries, industry, consumer groups (Option (1)): it is uncontroversial. However, remuneration disclosure is a highly controversial issue which is vividly opposed by insurance intermediaries. They advocated a disclosure regime on request by the customer because they claimed that, in particular for the sale of general insurance products, a full disclosure regime could lead to vertical integration (intermediaries withdrawing from the market). Mandatory disclosure is supported by consumer groups (FSUG, BEUC, German association of consumers, etc.). The adoption of ethical codes (the soft law option) is favoured by intermediaries.

Under the **baseline scenario**, different consumer protection and conduct of business rules in different Member States and sales channels would remain. This could lead to regulatory arbitrage and an unlevel playing field. As Member States would further regulate in this area, this could result in even less cross-border trade (as against the current situation: 5%) (obj. 1, 2 & 3). The previous preferred option changes the market landscape and would introduce new, more negative trends.

In terms of achieving higher consumer protection (obj. 1), **Option (1)** would offer higher transparency compared to the **baseline scenario** regarding the nature, the structure and the amount of the intermediary's remuneration and it would provide clarity with regard to the principal-agent relationship, including how this may impact on advice. There are studies from the UK indicating that there is a risk of "over-informing" the consumer.⁹⁷ One study indicates that products with low premiums and high remuneration may be rejected despite the value of cover.⁹⁸ The Commission Services, however, take the view that consumer protection has moved forward significantly over the last years, and that consumers are today increasingly information-seeking and cost-conscious. Disclosure of the different elements of the total price - including the broker's remuneration - will enable the client to choose on the basis of insurance cover, linked services (for example if the intermediary does

⁹⁶ This option is a compromised suggestion by key stakeholders and EIOPA.

⁹⁷ An Empirical Investigation into the Effects of the Menu, CRA International, 3rd May 2007, http://www.fsa.gov.uk/pubs/other/CRAreport_menu.pdf

Consumer Decision-Making in Retail Investment Services, Nick Chater, Steffen Huck, Roman Inderst, Final Report for the European Commission, November 2010, http://ec.europa.eu/consumers/strategy/docs/final_report_en.pdf

Information versus Persuasion: Experimental Evidence on Salesmanship, Mandatory Disclosure and the Purchase of Income and Loan Payment Protection Insurance, David De Meza, Bernd Irlenbusch, Diane Reyniers, London School of Economics, Commissioned by the FSA, November 2007, http://www.fsa.gov.uk/pubs/other/DeMeza_Report.pdf

⁹⁸ Impact of commission disclosure in general insurance personal lines, report from Charles River Associates, ABI research paper no 26, 2010, http://www.abi.org.uk/Publications/ABI_Publications_Impact_of_Commission_Disclosure_in_General_Insurance_Personal_Lines_ABI_Research_Paper_No_26_cf8.aspx

claims-handling) and price. This will further suitable, cost-efficient products and intermediary services for consumers (opinion of the German consumer association and BEUC).

Option (1) (both mandatory disclosure and on request disclosure) would have positive effects on competition (obj. 2) in insurance distribution as it would ensure that consumers receive wider information on products and costs, as well as possible conflicts of interest. It would be easier for consumers to compare insurance covers and prices between products sold through different distribution channels. Certain stakeholders argue that competition could be distorted and vertical integration encouraged if intermediaries have to disclose their remuneration. Several EU Member States do already require remuneration disclosure for all insurance products, and MiFID will require this for all PRIPs products. The new information will give consumers more complete information about what services the intermediary performs and what are the related costs. The remuneration disclosure must however be implemented in a way that the comparison between intermediaries and direct writers are ensured. It has been argued that calculations of "commission-equivalent" figures for direct writers are complex to perform (quote from industry commentator). The Commission Services believe that information about the price of cover as well as the distribution costs would provide comparability. In particular - for avoiding situations of conflict of interest - the employee's variable remuneration resulting from the sale of a product should be disclosed. (*The market impact is analysed more in detail in chapter 8.*)

Comparison table for Options (1) Sub-options a) and b).

Topic	Option 1 a) Mandatory disclosure	Option 1 b) On request disclosure
<i>Data required:</i>	Intermediaries need not obtain further data.	As mandatory.
<i>Transparency:</i>	Clients should know what is paid on their behalf for the intermediary's services. Transparent between fee-based services (some other intermediated financial products), and commission-based.	Does not lead to same level of information to consumer (Industry states most customers have no interest.)
<i>Conflict of interest</i>	Will be apparent if intermediary gets higher commission on one product over another.	It will not be apparent if intermediary is acting in his own interest rather than customer's unless customer requests disclosure of commission

Topic	Option 1 a) Mandatory disclosure	Option 1 b) On request disclosure
<i>Costs</i>	Some systems changes needed to enable these amounts to be disclosed to their clients.	Can be done on ad hoc basis (may not save on costs)
<i>Vertical integration</i>	<p>Clients go directly to insurance companies to avoid paying a commission (Remuneration disclosure may have an initial impact on consumer behaviour, but if as industry also says, customers buy on price alone, showing how much of premium is paid as commission will make no difference in the longer term).</p> <p>Due to internet sales and development of complex products consolidation will be seen in this sector regardless.</p>	Vertical integration risk removed / reduced

Option (1) would furthermore address certain key problems related to cross-border provision of insurance intermediary services: lack of legal certainty and lack of comparability. If the harmonised legal framework is improved, intermediaries as well as their customers may more readily take the step of selling or buying insurance products cross-border. Improved disclosures would facilitate comparison between products and distribution channels, which is today particularly difficult in cross-border trade situations. (obj.3.)

When assessing effectiveness in achieving higher level of consumer protection and clear conduct of business rules (obj. 1), **Option (2)** may not be that beneficial as it leads to a decrease in the insurance coverage of those clients who are not willing to/could not afford to pay for financial advice. To assess this option against the objective of undistorted competition (obj. 2), the PwC study and stakeholders (intermediaries) noted that as the direct sales sector would not be affected by a ban, it would also gain from lack of competition, and from the absorption (internalisation) of brokerage and agency portfolios. (Market shares of brokers diminished when Finland introduced a ban on commission). Many brokers and intermediaries would leave the market or would attempt to convert to paid salespeople, leading to internalization of sales that were previously made through intermediaries. As regards

impact on consumers, premiums might go up because of market concentration (as many intermediaries would exit the market). With regard to market integration, (obj.3.) the effect is likely to be negative, as indigenous firms would enjoy a clear advantage over foreign firms as the latter often use intermediaries to market their products. Foreign companies would have difficulty entering national markets, and consumer choice would suffer regarding product range. On the other hand, uniform requirements in all Member States would provide legal certainty for all market participants.

Existing legislation and self-regulatory standards (developed by the profession) do not provide enough clarity to stakeholders and are considered to be ineffective due to unenforceability (**Option (3)**). Self-regulation can be in the form of protocols between trade associations or in the form of non-binding ethical codes⁹⁹. This is a workable solution in B2B relationships but not for B2C. Therefore one can presume that further self-regulation would never be able to achieve the same level of effectiveness as any of the above considered options ((1) to (2)).

Compliance costs implications

As for costs, under Option (1 and both for suboptions a) or b)) intermediaries can respond to requests for commission information (they already possess the relevant data anyway) without putting in place complex systems. No specific costs estimates were volunteered, either by the interviewees of the PwC study nor by the stakeholders who responded to the public consultation. The Commission Services' best estimates for all sellers are: **average €200 (one-off costs) /company and average €100 (recurring costs)** (printing, training, IT, paper, and administration costs, etc.). It is difficult to quantify the level of costs for the two alternatives (suboptions a) or b)) but it will depend on consumer behaviour and markets (also up to product markets and different Member States). If normally the market is such that a regular consumer want more transparency (for example, in case of more complicated, costly products and in some Member States such as the Nordic countries), the costs for a mandatory and for an on request regime will be similar. If consumers are only interested in the final price of the product, fewer would ask for a disclosure of remuneration. Under the on request regime, intermediaries can respond to ad hoc requests for commission information without putting in place complex systems to deal with requests. However, the intermediaries will have to put in place some kind of measures so that they are able to fulfil the request for information. But because the information will only have to be presented to the customer on request, the costs will probably be lower in connection to this regulatory regime than the cost associated with a mandatory disclosure regime.¹⁰⁰ As regards Option (2), administration costs would go up for sellers of insurance products as they would have to bill separately for advice. The Commission Services' best estimates for all sellers are: very high costs according to estimation by respondents to PWC questionnaire and public consultation (no quantifiable costs estimates were volunteered, either by the interviewees of the PwC study, nor by the stakeholders who responded to the public

⁹⁹ There is already a protocol in place in business to business relation (B2B) BIPAR-FERMA, Protocol on Transparency, http://srhy.fi/uploads/uutiset/Bipar_Ferma_Protocol_final-2.pdf

¹⁰⁰ EIOPA advice

consultation).¹⁰¹ Option (3) entails only limited costs. These ethical codes exist already in several Member States.

Overall assessment: The preferred option is Option (1) (a or b) because it achieves the objectives at a low cost. The benefits outweigh the costs because this option ensures more transparency as regards the relationship between the seller and the product manufacturer (insurance company). The level of benefit cannot be quantified but see more qualitative explanation in section 8. Therefore, this will mitigate the conflicts of interests and the information asymmetry between the seller and the buyer.

Preferred option In order to ensure proportionality, it is suggested introducing an on-request regime for the sales of non-life products with a 3 years transition period. This will allow SMEs to prepare and adjust themselves to the legislative change and measure the impact of the suggested change in real life. This is in line with the views of most stakeholders (intermediaries, insurance industry) as well as EIOPA and, at the same time, ensures proportionality and flexibility towards SMEs. It will provide a useful midway balancing consumer groups' and intermediaries' as well as SME's interests.

Issue 2. Conflicts of interests ¹⁰² Insurance PRIPs only	Effectiveness (benefits)			Cost effectiveness
	Consumer protection and clear conduct of business rules (Obj.1.)	Undistorted competition (Obj.2.)	Market integration (Obj.3.)	
0 – Take no action (Baseline scenario)	0	0	0	N/A
1 – Apply revised MiFID entirely, conduct of business rules and organisational requirements (risk management, internal audit, etc.) (MiFID Level 1 and 2)	+	++	+	--
2 – Introduction of a revised MiFID-like regime based only on the conduct of business rules (identify, manage and mitigate all conflicts of interest (Article 23 of MiFID II) Level 2 guidelines by ESMA/EIOPA	++	++	++	++
3– Soft law (issuing guidelines, self-regulation, ethical codes, etc.)	--	--	0	0
4 – Prohibition of products difficult to understand even for professional market participants	--	--	++	--

Stakeholders' view: The majority of stakeholders (consumers, investment firms, insurance industry) supported the idea that high level MiFID-based conduct of business rules should be introduced for the sale of insurance PRIPs.

¹⁰¹ Idem footnote 84.

¹⁰² NB. The option chosen for general insurance products already applies also to insurance PRIPs, however, the previous options cannot address all problems related to this market because insurance PRIPs are similar to investments therefore higher consumer protection standards should apply (see more explanations supra).

Under the **baseline scenario**, no consistency with MiFID would be ensured. This means less protection for consumers buying insurance investments compared to other PRIPs. Market players would be subject to different regulation, which leads to an unlevel playing field. Member States can develop different rules, which leads to regulatory arbitrage. This can result in a fragmented internal market as sellers have to comply with different rules (see section on problems) (obj. 1, 2 &3).

In terms of achieving a higher level of consumer protection and clear conduct of business rules and undistorted competition, (obj. 1&2), **Option (1)** would ensure that the same rules would apply to all investment-based products. More specific disclosure of an intermediary's commercial relationship to financial services groups, and their roles or functions, may be beneficial to clients. It would ensure coherent and similar conflicts of interests' rules for sellers of investment-based products. However, for market players, this would mean double supervision and registration (under IMD2 and MiFID) and three sets of organisational rules to be respected (under Solvency II, IMD2 and MiFID). Also, increasing the number of documents and/or the complexity of the documents provided to clients may be counterproductive as clients may neither read nor understand the content or its significance. As for market integration (obj. 3), this option would enhance cross-border trade, as uniform requirements in all Member States would provide legal certainty for all market participants and facilitate monitoring procedures by the competent authorities.

In terms of achieving a higher level of consumer protection and clear conduct of business rules and undistorted competition (obj. 1&2), **Option (2)** would provide consumers similar benefits as Option (1) and it would offer the same protection as full MiFID does. This solution, however, allows full consideration of the sectoral specificities of life insurance policies with investment elements which can include specific benefits (e.g. partial biometric risk cover) or withdrawal rights, which are unique to these products. For market players, it would ensure coherent and similar conduct of business rules for investment-type products. As for market integration (obj. 3), this option would also enhance cross-border trade, as uniform requirements in all Member States would provide legal certainty for all market participants and facilitate monitoring procedures of the competent authorities and enforcement (same benefits as in Option (1)). This may also prevent possible supervisory difficulties as most Member States do not have unitary supervisory authorities responsible for insurance mediation and they are separate from those responsible for investments.

Option (3): Existing legislation and self-regulatory standards (developed by the profession) do not provide enough clarity. Mis-selling cases can be further expected. It has been proven ineffective due to the non-binding character of the measures in the field of financial services.

In terms of achieving a higher level of consumer protection and clear conduct of business rules and undistorted competition (obj. 1&2), **Option (4)** would provide consumers with similar protection and market players with legal certainty. However, this would narrow the choice of products available for consumers. As a consequence, other competitors selling similar investment-based products (whether or not falling under MiFID) such as pensions would drive insurance-investment sellers out of the market and competitors would gain bigger market shares (and this may lead to

market concentration). From the point of view of market integration (obj.3.), this would be beneficial as similar rules will apply in the EU.

Cost implications

As for costs, **Option (1)** would entail very high costs¹⁰³. These costs are disproportionate for SMEs. The regime could lead to additional costs compared to Option 2 (double organisational requirements, double registration, double supervision, high administrative burden linked to internal audit, risk management systems) which would particularly concern smaller organisations and intermediaries. The Commission Services' best estimates are: average cost: **€100,000 (one-off costs) and 35,000€(recurring costs estimates)/per company.** **Option (2)** is the most cost-effective as it would entail a fraction of costs compared to Option (1). Total costs are only calculated in relation to Level 2 measures as Level 1 rules only contain high level principles therefore these will not entail any costs. Total costs of level 2 measures would entail IT costs, training cost, administrative costs, costs related to adjusting data, etc. according to the PwC study and the public consultation. No quantifiable costs estimates were volunteered neither by the interviewees of the PwC study nor by the stakeholders who responded to the public consultation. However, based on the above mentioned Europe Economics study¹⁰⁴, estimates of the likely one-off impact can be made as follows:¹⁰⁵(these categories of sellers are only those who sell PRIPs insurances):

- for intermediaries (agents, brokers) of €50–€125 million;
- for banks of €125–€175 million.
- for insurers of €175–250 million

This would mean **total one-off costs** of **€350–€550 million.**

The estimate for the ongoing costs are:

- for intermediaries (agents, brokers) an ongoing annual impact of €25–€80 million;
- for banks, an impact of €35–€60 million.
- for insurers, €50–€80 million

This gives a **total of €110–€220 million** in ongoing costs.¹⁰⁶

¹⁰³ See PwC study.

¹⁰⁴ http://ec.europa.eu/internal_market/consultations/docs/2010/prips/costs_benefits_study_en.pdf

¹⁰⁵ For the purposes of this report we are assessing the potential impact of introducing new MiFID-style regulations in the following areas (MiFID I+ Level 2):

(a) Suitability and appropriateness tests — Articles 19 (4) and (5) of MiFID and Articles 35-39 of Directive 2006/73/EC (MiFID Implementing Directive).

(b) Conflicts of interest — Article 18 of MiFID and Articles 21-23 of the MiFID Implementing Directive.

(c) Inducements — Article 26 of the MiFID Implementing Directive.

¹⁰⁶ See further analysis in Annex 10. (Section 3.6.) Overview of Turnover, Operating Costs and One-Off Cost Estimates for all companies broken down by Size of Company.

Explanatory table

<i>Registration costs, training, organisational requirements:</i>	No additional cost compared to IMD 1
<i>Introduction business card solution and disclosure:</i>	EUR 200 per company one-off, EUR 100 recurring
<i>Training costs:</i>	N/A
<i>Cost for implementing MIFID conduct of business rules per intermediary:</i>	EUR €7,500 one-off

The main drivers of one-off costs include IT costs, staff training, project management, legal advice, consultancy communication (including document preparation & translation), development & reorganisation of internal policies/processes, staff recruitment. The main drivers of ongoing costs include costs linked to additional staff, staff training, IT, ongoing legal advice, internal and external reporting, internal audit, communication.

Option (3) entails only slight cost as those ethical codes exist already in several Member States. **Option (4)** would involve high costs as existing PRIPs products would have to be withdrawn from the market or transformed into other investment-type products.

Overall assessment: The Commission Services propose to introduce high level rules, based on the MiFID Level 1 text, requiring firms to identify and manage conflicts of interest. For instance, the UK introduced MiFID-based conflicts of interest requirements for insurance intermediaries in 2008. The cost-benefit analysis¹⁰⁷ in the UK as well as the above mentioned Europe economics study concluded that the overall cost to firms would be unlikely to be significant; therefore the preferred option is Option (2). Companies already subject to MiFID in other areas of their business, for example, may apply such policies to the relevant non-MiFID products to earn reputational benefits or in order to streamline their business in some way. Since banks are more likely to already be subject to MiFID in other areas of their business, and insurance PRIPs represent a smaller proportion of their business than for life insurance companies, this result supports the idea that the higher the proportion of the business that insurance PRIPs represent, the higher the one-off costs are likely to be.

7.3. Advice

Issue 3. Advice A. Inappropriate/biased quality advice General insurance and insurance PRIPs	Effectiveness (benefits)			Cost effectiveness
	Consumer protection and clear conduct of business rules (Obj.1.)	Undistorted competition (Obj.2.)	Market integration (Obj.3.)	
0 – Take no action (Baseline scenario)	0	0	0	NA

¹⁰⁷ CP 07/23 Organisational systems and controls – extending the common platform
http://www.fsa.gov.uk/pubs/cp/cp07_23.pdf

1 – Introduce a suitability test as part of the advice process for the sales of all insurance products	--	--	+	--
2- Introduce definition for "insurance advice".	+	+	+	0
3- Ban on commission for independent advice (Art 24 MiFID II)	+	++	+	+

Stakeholders' view: The vast majority of stakeholders supported the introduction of insurance advice. Some stakeholders (mainly consumer groups) recommended that advice should be defined as a personalised recommendation to subscribe to an insurance policy. They claim that a distinction is to be made from general information which is not personalised for a consumer and does not amount to a non-advised sale, and which should remain outside the scope of the IMD. Some stakeholders (consumers) support a ban on commission for independent advice as it ensures higher standards (thus promoting consumer protection). This approach is not supported by intermediaries.

Under the **baseline scenario**, the preferred options on conflicts of interests would allow customers to evaluate the advice received, taking into account the economic advantage for the intermediary connected with the policy's subscription. But the consumer would have the impression that he does not have any commission cost for advice if he buys his policy through direct channels.¹⁰⁸ Also, there are no similar foreseeable rules applicable for all sellers at EU level which can lead to regulatory arbitrage (obj.1, 2 &3).

Option (1) would not be beneficial for the consumer in general insurance product sales, as it would increase the number of documents and/or the complexity of the documents provided to clients. As for market players, a MiFID based suitability test is not relevant for general insurance products (such as motor insurance) (obj. 1). This would mean less choice of products as SMEs could be driven out of the market. Smaller intermediaries would be disadvantaged by a regime whereby they were required to test consumers' needs excessively. Larger organisations would benefit from economies of scale in administration and governance regimes and therefore would be less impacted (obj. 2). However, similar, foreseeable rules applicable for all sellers could enhance cross border sales (obj.3).

Option (2) would create clearer rules, whether the sale takes place on an advised or a non-advised basis, for consumer and market players (obj. 1). Wider choice, in terms of selling/purchasing on an advised or non-advised basis, would be achieved (obj. 2). As under Option (1), it would ensure that similar, foreseeable definitions applicable for all sellers could enhance cross border sales (obj. 3).

Option (3) would create more transparency but this could have a slightly negative effect on more vulnerable consumer groups which have less understanding of insurance products and are not willing to pay for independent advice. As for market players, more transparency would mean clear rules. This is not a preferred option because it would lead to potentially negative consequences for more vulnerable consumers and their ability to gain insurance coverage. The business card solution, giving the knowledge of whether an intermediary is under a contractual obligation to

¹⁰⁸

Idem footnote 84.

conduct insurance intermediation business exclusively with one or more insurance undertakings, makes a difference to the expectations of the customer with regard to independence and value of the advice (obj. 1). This option, however, may level the playing field between sellers selling substitutable products. This option would provide wider choice in terms of product/service as consumers/sellers can decide whether or not to proceed on the basis of independent advice (obj. 2). Harmonised rules applicable for all sellers could enhance cross border sales (obj. 3).

Cost implications

As for costs, according to the PwC study and vast majority of stakeholders (intermediaries, insurers) Option (1) would entail high additional costs which would fall disproportionately on smaller organisations and intermediaries, especially those selling simpler products and not selling investment products. For example, banks already comply with MiFID suitability test, therefore this is not a new obligation for them.¹⁰⁹ Option (2) would not involve significant costs for market players because this only means to provide customers with clarification what advice means. Cost is not quantifiable for Option (3) but according to the PwC study significant costs would arise for firms choosing to provide independent advice paid for by consumers who have a demand for such service. Entire IT system would need to be reorganised which would entail high costs. Premiums might go up as customers should pay for advice separately.

Overall assessment: The preferred option is Option (2) because this would entail only slight costs and ensures that the objectives are fulfilled.

Issue 3. Advice A. Inappropriate /biased advice Insurance PRIPs only ¹¹⁰	Effectiveness (benefits)			Cost effectiveness
	Consumer protection and clear conduct of business rules (Obj.1.)	Undistorted competition (Obj.2.)	Market integration (Obj.3.)	
0 – Take no action (Baseline scenario)	0	0	0	NA
1 – Introduce a suitability test as part of the advice process for life insurance products (PRIPs), detailed suitability test (Level 2) based on Art 25 MiFID II	++	+	+	+
2- Ban on commission for independent advice (Art 24 MiFID II)	+	++	+	+

Stakeholders' view: The vast majority of stakeholders supported the suitability and appropriateness test applied in the context of PRIPs sales (insurers, consumers, intermediaries). A majority of stakeholders (insurers, consumers) supported the introduction of a ban on commission for independent advice in PRIPs department, except for intermediaries because of their fear that some a number of small providers might exit the market as a result of the ban on inducements (see explanation below).

¹⁰⁹ Idem footnote 84.

¹¹⁰ The option chosen for general insurance products already applies also to insurance PRIPs, however, the previous options cannot address all problems related to this market because insurance PRIPs are similar to investments therefore higher consumer protection standards should apply (see more explanations supra).

Under the **baseline scenario**, no consistency with MiFID would be ensured. This means less protection for consumers buying insurance investments compared to other PRIPs (see section on problems). Market players are subject to different regulation that would lead to an unlevel playing field as Member States would develop different rules which would lead to a fragmented Internal Market as sellers would have to comply with different rules. In most of the Member States the sellers of insurance products are not obliged to provide the clients with sufficiently detailed advice; this is necessary especially when complex products are sold to them (obj.1, 2 &3.).

Option (1) would ensure better consumer protection rules (obj. 1) as it would give a better understanding of the preferences of consumers when buying more complex life insurance products, resulting in consumers' needs being better served. Levelling the playing field between sellers selling interchangeable and substitutable products which serve investment purposes would result in wider choice for consumers (obj. 2). Harmonised rules applicable for all sellers could enhance cross border sales (obj. 3).

Option (2) would create more transparency but this could have a slightly negative effect on more vulnerable consumer groups which have less understanding of complex insurance products but are not willing to pay for independent advice. In the case of sale of PRIPs this negative effect is outweighed by the fact that the PRIPs are complex and expensive products and if sellers receive commissions from the insurance companies this could lead to conflicts of interests which bring significant consumer detriment (obj. 1). With regard to undistorted competition, (obj. 2), the introduction of independent advice is not likely to distort competition since an independent broker providing independent advice will be competing with other intermediaries providing fair analysis advice¹¹¹ without either of the two having unfair competitive advantages stemming from the current regulation. Consumer might switch between the two types of advice and advisers will see which business model is viable for them. There is a possibility that small brokers would not find it profitable to provide independent advice and either become tied agents¹¹² or sell only non-PRIPs products (obj. 3). Harmonised rules applicable for all sellers could facilitate cross border entry.

Compliance cost implications

Option (1) and Option (2) are cost-efficient, as implementation costs would be compensated by benefits for firms (most entities selling different categories of investments and investment based insurances (such as PRIPs) would apply the same rules irrespective of products they sell and clients.¹¹³ Costs would be for firms choosing to provide independent advice paid for by consumers who have a demand for such service. No separate costs calculations were made for Options (1) and (2). Total costs are only calculated in relation to Level 2 measures as Level 1 rules only contain high level principles therefore these will not entail any costs. Total cost implications of level 2 measures were already presented in section 7.2. (together with conflicts of interests for sales of PRIPs insurances, cost analysis for Option (2).

¹¹¹ We refer to fair analysis advice as concept of advice that is given on a non-independent basis. (Art 12.(3) of IMD1.

¹¹² Art 2 of IMD1.

¹¹³ Idem footnote 84.

Overall assessment: The preferred options are Options (1) & (2) because these would provide a high level of consumer protection for the sales of investment-based insurances products.

Issue 3. Advice A. Low quality advice General insurance and insurance PRIPs	Effectiveness (benefits)			Cost effectiveness
	Consumer protection and clear conduct of business rules (Obj.1.)	Undistorted competition (Obj.2.)	Market integration (Obj.3.)	
0 – Take no action (Baseline scenario)	0	0	0	N/A
1 – Ensure that professional qualifications are proportionate to the complexity of the products sold (guidelines to be drafted at Level 2 by EIOPA/ESMA)	+	++	+	+
2 – Full harmonisation of professional qualifications regime setting high level of requirements (irrespective of the complexity of the product sold)	+	++	+	---
3- Soft law (issuing guidelines, self-regulation, ethical codes)	+++	+	+	0

Stakeholders' view: This is an uncontroversial issue. The vast majority of stakeholders agreed that professional qualifications should be proportionate to the complexity of the products sold. The soft law approach was encouraged by the intermediaries.

Under the **baseline scenario**, differently qualified salespersons would continue to face the client. Different levels of qualification requirements, depending of the type of sales and national requirements would continue. The current figure for cross-border trade (5%) could continue (obj.1, 2 and 3).

Defining the competence profile of a qualified insurance seller (**Option (1)**) would ensure that the consumer faces similarly qualified salespersons across all sales channels, as appropriate for the business being conducted (obj. 1). It would not put up barriers for intermediaries who may be able to demonstrate competence through market experience. It would not require too high a level of knowledge and ability from market players selling simpler general insurance which is incidental to their main business (obj. 2). Mutual recognition of intermediaries' knowledge and ability would render the cross-border process more effective. Those intermediaries who are operating in markets with lax rules would be competing with more qualified intermediaries when operating on a cross-border basis (obj. 3). This option would reflect proportionality as, for instance, persons who are working in the marine division of an intermediary do not need knowledge on, say, car insurance.

In order to realize the best consumer protection and undistorted competition (obj. 1&2), **Option (2)** would ensure that everyone responsible for insurance mediation activity should demonstrate the same technical knowledge and ability. Restricting competence to a full qualifications framework may put up barriers for intermediaries who may be able to demonstrate competence through market experience. Those who usually sell simpler products would be driven out of the market (due to standardised qualification requirements). Total harmonisation of training requirements might

render cross border trade more effective because no mutual recognition is needed (obj.3.)

Option (3): Existing legislation and self-regulatory standards (developed by the profession) do not provide enough clarity to stakeholders. However, proportionality and subsidiarity should also be considered. Training also has a competitive aspect; indeed, the knowledge of the persons working in an insurance intermediation business distinguishes the business from another intermediation business.

Compliance cost implications

The vast majority of stakeholders replying to the public consultation suggested that Option (1) would be the most cost effective system without providing quantifiable data. This option would require appropriate knowledge and ability for all those who are in contact with the consumer. The costs for Option (2) would be the highest (training costs). To develop an exhaustive list of all the desired competencies and abilities for insurance sellers that suit each Member State could be too challenging or not feasible. Option (3) would involve slight costs. Exact cost will be measured in the impact assessment at Level 2.

Overall assessment: Options (1) & (3) combined would ensure that training rules are designed to the needs of markets/market players/products and proportionality is taken into account.

3. B Low quality advice ¹¹⁴ Insurance PRIPs only	Effectiveness (benefits)			Cost effectiveness
	Consumer protection and clear conduct of business rules (Obj.1.)	Undistorted competition (Obj.2.)	Market integration (Obj.3.)	
0 – Take no action (Baseline scenario (3.A.) which means that professional qualifications are proportionate to the complexity of the products sold (guidelines to be drafted at Level 2).	++	++	++	N/A
1– Full harmonisation of professional qualifications regime	++	--	+	----

Stakeholders' view: The vast majority of stakeholders agreed with the baseline (see in the table). For instance, EIOPA and intermediaries preferred to retain responsibility for specifying details of professional standards at national level even for sellers of PRIPs insurances.

¹¹⁴ NB. The option chosen for general insurance products already applies also to insurance PRIPs, however, the previous options cannot address all problems related to this market because insurance PRIPs are similar to investments (see more explanations supra).

When the **baseline scenario** is assessed, the assumption is that the previously identified preferred options have already taken effect. To achieve all three objectives to the best level, the earlier options would mean that IMD2, plus the Level 2 measures would require similar professional qualification rules as contained in MiFID II. This option would not involve any cost (obj. 1&2, 3).

Option (1) a common knowledge and ability requirement system, irrespective of the method of distribution, would be beneficial to consumers and market players (obj.1.) However, restricting competence to a full qualifications framework may put up barriers for intermediaries who may be able to demonstrate competence through market experience. Those who usually sell simpler products would be driven out of the market (due to standardised qualification requirements) (obj. 2). Total harmonisation of training requirements might render cross border trade more effective (no mutual recognition procedure) (obj. 3).

Compliance cost implications

Costs (training costs) for Option (1) would be much higher than under option (0), and this is not compensated for by benefits. To develop an exhaustive list of all the desired competencies and abilities for insurance sellers that suit each Member State could be too challenging (too costly) or simply not feasible (due to the overlapping national competence).¹¹⁵ Exact costs will be measured in the impact assessment at Level 2.

Overall assessment: The preferred option is Option (1) because this ensures proportionality and effectiveness at a low cost.

Proportionate approach to preferred policy options in problems 2 and 3 (explanatory table)

Conduct of Business rules	
Information requirements– Disclosure rules – Advice standards – Professional requirements	
High + Level 2	PRIPs insurances
Standard	All insurance products
Low	Ancillary service provider (car rental firms, travel agents, suppliers of goods not meeting conditions for the exemption) + after sales players (loss adjusters, claims handlers)

¹¹⁵ Idem footnote 84.

7.4. Cross-border business

Issue 4. Cross-border business	Effectiveness (benefits)			Cost effectiveness
	Consumer protection and clear conduct of business rules (Obj.1.)	Undistorted competition (Obj.2.)	Market integration (Obj.3.)	
0 – Take no action (Baseline scenario)	0	0	0	N/A
1– Revise "general good" rules	0	+	+	--
2 – Introduce FOS and FOE definitions and mutual recognition system as well as a simpler notification system process	0	+	++	+
3 – Introduce a centralised registration system	++	+	++	+
4- Soft law approach	-	0	0	0

Stakeholders' views: The preferred options were in line with EIOPA advice and the vast majority of stakeholders (consumers, intermediaries, insurers) agreed on it.

Under the current situation (**baseline scenario**), the level of cross-border trade in insurance is very low and it would not increase significantly (see section on problems).

Option (1) would not substantially affect consumer protection (obj. 1). More competition would be expected at EU level due to the clarity of rules applied by Member States (obj. 2). This scenario would be positive in relation to market integration as similar rules are to be applied for all cross-border trade in insurance services (obj. 3).¹¹⁶

Option (2) would not substantially affect consumer protection (obj. 1) either. More competition through a less burdensome notification system and more willingness by sellers to go cross-border can be achieved through this option (obj. 2). Clarification of the definitions of freedom of establishment and freedom to provide services would render the cross-border process more effective (the vast majority of stakeholders in the public consultation agreed on this option). It is likely that fewer complaints related to registration problems would be received if this option were implemented (obj. 3).

Option (3) appears plausible in achieving the objective of consumer protection. It would provide easily accessible information to the consumer. The consumer would be able to check the status of an intermediary (in which capacity he is acting; where he is registered) (obj. 1). There would be more competition due to easier access to cross border markets and easier market mapping (whereby one can check how many competitors are on the market) (obj. 2). Market integration would be improved as a central website through which notifications could be submitted would make it easier for firms passporting in to other countries (obj. 3).

¹¹⁶ EIOPA advice.

Option (4): Existing legislation and self-regulatory standards (developed by the profession) do not provide enough clarity to stakeholders. Mis-selling cases can be further expected. The Luxembourg Protocol would co-exist with other soft law guidelines. This may create legal uncertainty (obj.1, 2 &3).

Compliance cost implications

As for the costs, Option (1) is too burdensome in terms of codification and subsidiarity. To develop an exhaustive list of all the desired "general good rules" that suits each Member State might be too challenging or not feasible at this stage. The costs involved cannot be quantified at this stage. The cost of implementation of Option (2) would be low because Luxembourg protocol already contains these definitions. Estimated administrative burden for setting up a mutual recognition system is €30/market players (but only for those who want to go cross-border). The compliance costs for such a mutual recognition regime is around €600/market players but 95% of the total cost is business as usual costs (costs related to the current notification process, fees for certifications, fees for translations) As for Option (3), the initial (one-off) fee would be low. (according to the PwC study and stakeholders) The expected recurring costs are annual registration fees of €40 per company/year. Option (4) would entail slight costs.

Overall assessment: Options (2) & (3) are the preferred ones as they involve slight costs and they may trigger more cross-border trade.

7.5. Sanctions

Issue 5. Sanctions	Effectiveness (benefits)			Cost effectiveness
	Consumer protection and clear conduct of business rules (Obj.1.)	Undistorted competition (Obj.2.)	Market integration (Obj.3.)	
0 – Take no action (Baseline scenario)	0	0	0	N/A
1 – Introduce a general framework of sanctions and enhanced harmonisation of sanctioning power (guidelines level 2)	++	++	+	+
2 – Introduce fully harmonised sanction regime by unifying sanctioning powers and enforcement rules	++	-	+	--
3– Soft law	0	0	0	0

Stakeholders' view: Issues on sanctions were not included in the public consultation. The current impact assessment benefitted from the public consultation on sanction and on MiFID II.

The current scenario (**baseline option**) has so far failed to provide a sufficient level of deterrence for market players not to infringe IMD1 requirements (see section on problems). If the current system remains in place, consumers would not be protected at the same level in all the Member States. Market players would be subject to different sanctioning regimes depending on the regulation that they were required to comply with and the Member State concerned (obj. 1, 2 & 3).

Option (1) would be effective as it would immediately alleviate the administrative burden that a multitude of different sanction regimes entail. It would reinforce and harmonise powers for supervisors. This would provide better protection for persons providing information on infringements and more information on infringements for supervisors (obj. 1). In terms of achieving undistorted competition (obj. 2), this option would create a sounder insurance market thanks to more efficient fighting against unauthorised practices detrimental to customers. This would have a more dissuasive effect for infringers as well. It would limit regulatory arbitrage; therefore it would be effective for reaching market integration (obj. 3). It would be an initial step towards further harmonisation of sanctions across EU.

Option (2) would introduce reinforced and harmonised powers for supervisors. This would also entail better protection for persons providing information on infringements. That means full information on infringements for regulators and supervisors (obj.1). However, as regards competition issues, sanctions (e.g. level of fines) may be proportionately lower in some Member States where the economy is less developed but where the insurance market has the same level of penetration (obj.2). It would also limit regulatory arbitrage, and therefore would be as effective as Option (1) to promote market integration (obj. 3). It is already a step towards further harmonisation of sanctions across EU.

Option (3): Existing legislation and self-regulatory standards (developed by the profession) do not provide enough clarity to stakeholders and the effect would be the same as if the baseline scenario remains.

Compliance costs implications

As regards Option (1), costs would be compensated by benefits for all market participants and consumers who would receive better protection due to the deterrent effect of harmonisation of sanctions. As for Option (2), costs would not be compensated for by benefits, as this option is too costly. To develop an exhaustive list of all the desired "sanctions" that suits each Member State might be unfeasible at this stage (Option (3)). The soft law approach would entail slight costs (Option (4)).

Overall assessment: Option (1) is the preferred option because it leaves sufficient flexibility to Member States and is not too costly. Harmonisation of general rules on sanctions would not distort Member States' legal traditions.

8. ANALYSIS OF THE IMPACTS

8.1. Overall impacts of the package

Summary of the costs/benefit impact of the combined preferred options.

<u>Preferred policy options</u>	<u>Compliance costs</u>	<u>Expected benefits</u>
Extend the scope to all sellers of insurance products and after-sales apart from sales of insurance complementary to the	Total costs around €240,000,000 one-off, €1,2,00,000 ongoing costs (excluding claim handlers due to lack of data)	The consumer will get the same protection no matter which distribution channel he uses. So far 48% of the market

<p>supply of goods (e.g. opticians)</p> <p>Declaration regime for ancillary and after-sales services</p> <p>IN: direct writers, agents, brokers, travel agents, car rental firms, loss adjusters, claims handlers</p> <p>OUT of conduct of business rules: professional customers</p>	<p>IMD1: 737.740 entities</p> <p>IMD2: around 847000 entities (excluding claim handlers due to lack of data)</p>	<p><u>(insurance contracts sold) is covered by IMD1; the extension will cover about 98%.</u></p>
<p>Introduction of a European Standard for status information ("business card solution") and remuneration disclosure</p> <p>IN: direct writers, agents, brokers, travel agents, car rental firms, loss adjusters, claims handlers</p>	<p>Best estimates for all market players: average €200 (one-off costs) /company and average €100 (recurring costs) (printing, training, IT, paper, and administration costs).</p> <p>Aggregated costs estimates for the scope of IMD2: €168,200,000 (one off costs) €8,100,000 (recurring costs)</p>	<p>This could lead to better mitigation of possible conflicts of interests between the intermediary and the consumer arising from misaligned incentives. In order to ensure a level-playing field the insurance undertakings engaged in direct sales should disclose the variable remunerations of their employees linked to the sale.</p>
<p>Introduction of a definition of insurance advice</p> <p>IN: direct writers, agents, brokers, travel agents, car rentals, suppliers of goods not meeting conditions for the exemption</p>	<p>No costs is foreseen for introducing a definition of advice</p>	<p>This would benefit consumer choice and the quality of service received.</p>
<p>Introduction of a revised MiFID-like regime based only on the conduct of business rules (Level 2 guidelines by ESMA/EIOPA)</p> <p>IN: Sellers of insurance PRIPs</p>	<p>Cost is not measurable separately at this stage.</p> <p>Compliance costs would entail IT costs, training costs, administrative costs, costs related to adjusting data, etc. (No specific costs estimates were volunteered, either by the interviewees of the PwC study, or by the stakeholders responded to the public consultation.)</p>	<p>The consumer will get the same protection no matter what investment type product he buys.</p>
<p>Introduction of a suitability test as part of the advice process</p> <p>IN: Sellers of insurance PRIPs</p>	<p>(No specific costs estimates were volunteered, either by the interviewees of the PwC study, or by the stakeholders responded to the public consultation.)</p>	<p>This would benefit consumer choice and the quality of service received.</p>
<p>Ban on commission for independent advice</p> <p>IN: Sellers of insurance PRIPs</p>	<p>Total one-off costs of €350-€550 million and a total of €110-€220 million in ongoing costs.</p> <p>Average total costs: €450 million on-off, €65 million ongoing costs</p> <p>The estimated number of market entities that will be selling PRIPs insurances under IMD2 is around 500.000. The administrative burden therefore averages 800 EUR/company.</p> <p>The most significant costs item is</p>	<p>This would benefit consumer choice and the quality of service received.</p>

	related to the application of MiFID-like conduct of business rules to sellers of PRIPs insurances.	
<p>Professional qualifications are proportionate to the complexity of the product and soft law approach</p> <p>IN: direct writers, agents, brokers, travel agents, car rental firms, suppliers of goods not meeting conditions for the exemption and sellers of insurance PRIPs</p>	<p>Cost is not measurable at this stage.</p> <p>Exact cost will be measured in an IA at level 2.</p> <p><u>Commission services' educated guess based on stakeholders' input:</u></p> <p>Training costs: €250/company one-off and €150 ongoing costs (yearly).</p> <p>Total: €12 million one-off and €127 million ongoing costs (yearly).</p>	<p>This would benefit consumer choice and the quality of service received. Consumer will get the same information, no matter which distribution channel he uses.</p>
<p>Introduce provisions relating to freedom to provide services (FOS) and freedom of establishment (FOE) definitions and a mutual recognition system as well as a simpler notification process (to provide greater detail and clarity).</p> <p>Introduce a centralised registration system by EIOPA</p>	<p>No costs are foreseen for introducing definitions for market players</p> <p>Estimated administrative burden for setting up a mutual recognition system is €70/market players (only for those who wants to go cross-border).</p> <p>It is estimated that 100,000 entities will provide services cross border under the new IMD2.</p>	<p>EIOPA predicts more cross border entry</p>
<p>General framework for sanctions</p>	<p>No costs are foreseen for market players</p>	<p>One channel to strengthen deterrence and enforcement</p>

8.2. General expected impact of revised IMD on market structure

Insurance distribution markets differ significantly between Member States. Some markets may be slightly more affected by the introduction of IMD2, but the overall assessment is that no major changes to market structures for insurance mediation are expected due to IMD2. Recent statistics¹¹⁷ have shown that even in the Member States where the insurance regulation has been developed into the direction of MiFID already, meaning more transparency of the remuneration and higher consumer protection standards, the number of insurance intermediaries has not decreased. Moreover, the number of bankruptcies and defaults amongst insurance intermediaries has decreased and the level of consumer satisfaction has been improved. Of course, these figures could not be indicative for the entire EU market because of the different

¹¹⁷ Information received from supervisors.

market structures in the different Member States, however, it shows that more regulation in the insurance distribution field would be welcomed by a large number of stakeholders.

Indeed, some changes are expected irrespective of IMD2. It is expected that the increase in internet sales generally will lead to a further increase in the use of this distribution channel in relation to insurance products. This channel is used by both insurance undertakings and intermediaries. Some consolidation of the intermediary sector may be expected as a result. These changes are quite independent of IMD2.

Some consolidation can also be expected due to the introduction of more stringent selling rules for insurance PRIPs, based on the rules in MiFID. And for insurance PRIPs the trend towards more complex products means that this change would be likely to be seen in any event, although the regulatory changes may accelerate this.

Remuneration disclosure may have an initial marginal impact on consumers' behaviour, as some studies suggest that vertical integration (clients going directly to the insurance companies rather than through a broker) may occur. Remuneration disclosure may have an initial impact on consumer behaviour, but if as industry also says, customers buy on price alone, showing how much of premium is paid as commission will make no difference in the longer term. Improved information and increased transparency are likely to lead to better competition and benefit efficient intermediaries, as well as those offering specialised services/an enhanced level of service to their clients.

The ban on commission for independent advice in relation to insurance PRIPs is expected to have only limited impact, as this type of service is used less in insurance than for financial instruments. Accordingly these advisers are more likely to transform themselves into non-independent insurance intermediaries providing "regular" or "fair analysis" insurance advice, continuing to be remunerated by commission from insurance companies, than to leave the market altogether. The extent to which this occurs will depend on the extent to which consumers are willing to pay for "independent" advice.

No structural changes in the markets for ancillary insurance distribution are expected to result from the changes to IMD1. The relatively smaller amounts involved, as well as the clear ancillary nature of these products would make changes in consumer behaviour slower to appear.

Cross-border sales will increase in the longer perspective, but this is not expected to significantly change the structure of the market.

8.3. IMD2 proposed rules and their proportionate application to SMEs

8.3.1. Are the preferred policy options proportionate for smaller market players selling insurance products?

SMEs and Micros which carry on insurance mediation as their principal business are already subject to the IMD. They are accordingly currently subject to requirements as to good repute, competence, disclosure of status (in relation to conflicts of interest) and whether advice is given and on what basis. As noted above, some 48% of sales

are currently covered by the IMD, and this will increase to 98% under these proposals. That is mainly because of the inclusion of sales by insurance undertakings, which by virtue of the requirements of [the Insurance directives/Solvency II] are not SMEs.

Those intermediaries which are SMEs or Micros currently outside scope and which will be brought into scope by these proposals are essentially businesses whose principal activity is other than insurance mediation (so mediation is purely ancillary to their main business). These intermediaries will be subject to a light touch regime as a proportionate approach to the ancillary nature of the mediation they perform.

Proportional requirements have been introduced to take account of SME concerns and to respect the principle "less complex products, less complicated rules". This is expressed graphically below:

	Disclosure status	Registration	Professional qualifications (level)	Advice standard (level)
A. SME insurance intermediaries selling high risk products (PRIPS)	Full	Full	High	High
B. SME insurance intermediaries selling general insurance	Full	Full	Average	Average
C. Ancillary service providers (travel agents, car rental firms, suppliers of goods not meeting conditions for the exemption) and after-sales services (loss adjusters, claims handlers)	Full	Light regime (declaration only)	Light regime	Low
D. Seller of insurance policies ancillary to sale of goods, under 600 euro premium per year and satisfying other criteria under the exemption	none	none	none	none

8.3.2. *Impact on SME intermediaries selling insurance as their main activity (approx. 700 000 entities) - A and B categories*

A. SME insurance intermediaries selling high risk products (PRIP)

The only MiFID rules which it is proposed should apply are the conduct of business rules for investor protection. No other MiFID rule will apply. Organisational rules for insurance intermediaries and insurance undertakings are in the IMD or Solvency II.

The MiFID rules applied are high level rules and are adjusted to the specifics of the insurance sector. Level 2 measures are also proposed in this chapter in order to ensure those high level principles are applied proportionately. In this respect the Commission Services' approach already takes into account in a proportionate way the particular position of insurance intermediaries. Any different policy choice would mean that an investor/policyholder could expect different levels of protections depending on who is selling the same product to him/her. This does not seem a desirable result.

The fact that MiFID-based rules on conduct of business are applied to some insurance intermediaries does not necessarily mean extra administrative burden. All these MiFID requirements already apply to investment firms, which also include small entities. Moreover, proportionality is ensured in respect of applying MiFID conduct of business rules. It is proposed that MiFID conduct of business rules pertaining to investor protection (such as the proposed new restrictions on inducements; the provisions on mitigation of conflicts of interest; the suitability and appropriateness test) will be included in IMD2 to ensure a level playing field for the sales practices in relation to all PRIPs products across the investment and insurance sectors. The administrative burden of this approach is significantly less than applying the full MiFID rules written for the investment sector. The sellers of insurance products usually sell different types of products, including non-life insurance products - if they were required to register under MiFID for the sale of PRIPs it would mean double registration requirements: once under IMD (with insurance supervisory authorities) and secondly under MiFID (with investment supervisory authorities). The countries applying MiFID rules more widely than the MiFID scope (NL, IT, UK) tend to apply a proportionate approach to make the rules useful and suitable for insurance intermediaries, and they only apply the conduct of business rules in MiFID, not full MiFID.

B. SME insurance intermediaries selling general insurance products (agents and, brokers)

Most insurance intermediaries are SMEs involved in selling comparatively simple insurance products (e.g. general insurance). The impact of new registration rules on SME intermediaries is limited, as they already have to register under similar rules according to IMD1.

The main policy changes relevant for SMEs are the introduction of the business card solution and remuneration disclosure. The Commission Services' best estimates for all market players are around €200 one-off costs per company and around €100 recurring costs per company (printing, training, IT, paper, and administration costs). It should be noted that several Member States have already introduced similar requirements¹¹⁸. It appears that the biggest cost driver of the preferred policy option

¹¹⁸ Sweden, Finland and Denmark have a full disclosure of remunerations regime, the UK and Ireland has disclosure upon request and France apply disclosure upon request for premiums above 20 000 euros.

is remuneration disclosure. However, intermediaries already possess data about their remuneration. Where their data does not have (or cannot calculate) the exact amount in cash terms, they will still know the basis of the calculation of their remuneration. Accordingly, it is simply a question of developing systems for disclosure of this to customers.

As for the remuneration disclosure, a transitional period will be introduced. It means that a mandatory 'full disclosure' regime is envisaged for the sale of life insurance products and an 'on-request' regime (i.e. on customer's demand) for the sale of non-life products with transitional period of 3 years. After the expiry of 3 years transitional period, the full disclosure regime will automatically apply for the sale of non-life products as well. A 3-years-period is long enough to allow SMEs to prepare and adjust themselves to the legislative change and measure the impact of the suggested change in real life, whilst it is sufficiently short to put a full system in place in the foreseeable future. Very long transitional period would jeopardize the efficiency of the measure. This is in line with the views of most stakeholders (intermediaries, insurance industry) as well as EIOPA and, at the same time, ensures proportionality and flexibility towards SMEs. It will provide a useful midway balancing consumer groups' and intermediaries' as well as SME's interests. The transitional 'on request regime' minimizes the impact on smaller intermediaries where the cost of introducing systems to account for mandatory disclosure may be disproportionate to the number of customers who use and act on this information.

Concerning professional qualifications, 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. Exact costs will be measured in the impact assessment at level 2 at a later stage but no significant cost can be expected.

8.3.3. *Impact on SME intermediaries selling insurance as an ancillary activity (approx. 80 000 entities) - C and D categories*

C. Ancillary service providers (travel agents, car rental firms, suppliers of goods not meeting conditions for the exemption) and after-sales services (loss adjusters, claims handlers)

Apart from insurance complementary to the supply of goods, sellers of insurance ancillary to goods and services (including travel agents and car rental firms) would be within scope instead of full registration for these intermediaries, a simple declaration procedure is proposed. This will impose a lighter regime. The European business card rules and information provision rules will apply. Basic professional requirements and good repute (they should know the features of the products they sell, clean police record) are required. An insurance undertaking or registered insurance intermediary takes responsibility for ensuring the compliance of the intermediary concerned.

D. Fully exempted sellers of insurance products under IMD1

Sellers of insurance complementary to the supply of goods (such as mobile phones or glasses) remain out of scope, as in IMD1, except that (reflecting an increase which has already been implemented by Member States in compliance with provisions

contained in IMD1) the premium limit on an annualised basis is increased to €600 per annum which should be applied pro rata (less than €2 per day).

8.4. Employment and social impact

The impact for employment will likely be low, given that the initiative is more focused on amendments than on the introduction of new requirements that might have general impact. In general terms, the new requirements may have some marginal impact (training needed, some higher costs and thereby possible manpower consequences), but it is not expected that the direct impact would be material.

Social benefits result from better consumer information and advice when buying insurance products. This could lead to a lower number of defaults¹¹⁹ (early withdrawals), and mis-selling, and therefore a decreased level of consumer dissatisfaction and a more efficient insurance of consumer risks. Indirectly, greater levels of consumer confidence should contribute to growth in EU financial services more generally.

8.5. Administrative cost and administrative burden

Estimated administrative burden is: around **617 EUR millions (aggregated estimate)** for the first year of application of IMD2. This figure has been derived according to the following methodology:

Input for the administrative costs calculations

In order to estimate the administrative cost associated with the proposals, the Commission Services have used the PwC study (with significant adjustments), CEA statistics, BIPAR statistics, Eurobarometer, as well as some anecdotal evidence and own analysis by the Commission Services.

The Commission also organised in July 2011 a meeting with a number of stakeholders (BIPAR, FECIF, EFICERT, CEA, EUROSTAT, ECTAA, BMW, VW, Daimler Financial services) in order to collect data on the costs of the different policy options envisaged.

The PwC study as the starting point

The PwC study covered only five Member States and some participants were unwilling or unable to provide a precise estimation of costs.¹²⁰ In many cases total figures for administrative costs have been given, not specifically those related to the proposal.

The PwC study provided cost elements for the purpose of calculating administrative costs. Their estimations were combined with industry statistics (from the organisations listed above). As result, the aggregated administrative costs amount to

¹¹⁹ "Default and lapse" on your life insurance policy means that the client stops paying his/her premiums. In this case, the insurance company could use any money that the client has accrued in his/her policy to cover the unpaid premiums every month until the money is depleted.

¹²⁰ The following types of costs were taken into account by the above mentioned study: regulatory, internal supervision, training, sales and marketing, IT, administration and operation and other costs.

a maximum of 12,000,000,000 EUR in the field impacted by IMD2. This figure shows the full administration expenses for the running of insurance business activity across the whole EU. In order to arrive to the administrative burden estimate stemming from the current revision of the IMD1, the Commission services have estimated business as usual costs.

In order to arrive at a cost figure relating to the draft proposal, the Commission Services had the following observations:

Cost estimates were given, taking into account highly regulated, more mature markets (notably the UK). However, these markets already have considerably higher protection measures in place so the marginal cost of implementing the new proposals is much less.

It should be noted that the PwC study figures used for the calculation of the IT cost and the training cost linked to the preferred options (tables in section 5) have been based on data received from some large insurance companies from very developed insurance markets, such as the UK. Therefore, these figures must be revised in order to reflect the market reality in EU 27.

Cost estimates include "business as usual" costs. The **business as usual cost** corresponds to the cost resulting from collecting and processing information which would be done by an entity even in the absence of the legislation. Evidence shows (results of the public consultation, meeting with stakeholders) that insurance companies and intermediaries do possess the relevant data, IT equipment, training and other relevant systems in place in order to be able to remunerate the sellers of insurance products (i.e. to see how much commission or fee needs to be paid to them). The Commission Services – based on anecdotal evidence – have assessed the "business as usual" part to be between 50-95% of the cost estimates. For example, 95% of training costs related to business as usual, but merely 50% of the fee for the declaration procedure is business as usual costs for travel agents and car rentals as this is a new obligation for them at EU level. (They were only registered in national registration systems up to now, therefore 50% of the 'registration' fees still relates to the national registry (business as usual costs).

Further input for the calculations

Details on all calculations can be found in Annex 11.

The following figures were used to calculate the administrative costs and administrative burden of the different policy options:

Total estimated number of EU registered insurance intermediaries end-2010:	737 740. ¹²¹
Total number of EU insurance undertakings in the EU27 in 2009	4 618. ¹²²

¹²¹

Source: BIPAR.

¹²²

Source: CEA European market operators – 2009, 21 June 2011 - Statistical series (see <http://www.cea.eu/index.php/facts-figures/statistical-series/market-operators>, Number of companies operating on the market).

Total number of EU car rental companies and car leasing end-2009:	30 976.
Total number of EU travel agent companies end-2009:	68 000. ¹²³
Total training costs for intermediaries and employees of direct sellers	€150 yearly (ongoing) and €250 one-off cost ¹²⁴ <i>This cost figure covers all usual training costs for intermediaries, therefore the estimated business as usual cost is 95% of the total training costs.</i>
Business card solution – designing information material (leaflet design, printing, paper and distribution costs): Submitting the information (sending it to the designated recipient, i.e. giving business card and disclosing remuneration to the customer):	€200 on-off and €100 ongoing costs per entity ¹²⁵
Buying /Running (IT) equipment & supplies:	€100 ¹²⁶ . <i>This cost figure covers all IT costs, therefore the estimated business as usual cost is 95% of the total costs.</i>
Annual fee for running a central electronic registry :	40 euros ¹²⁷ /per intermediary. <i>Intermediaries are already registered under IMD2, therefore therefore the estimated business as usual cost is 95% of the total registration costs.</i>
Mutual recognition of foreign proof and	One-off costs of €600 ¹²⁸ . <i>As there is already notification</i>

¹²³ Source: Eurostat

¹²⁴ Source: BIPAR and Commission estimates

¹²⁵ PWC study gave us a highly inflated number: 2300 EUR which was corrected downwards on the basis of several stakeholders' opinion.. This cost figure covers all costs related to a yearly production of a business card. A similar already used in some Member States (UK, Germany, Belgium) , therefore the estimated business as usual cost is 95% of the total costs.

¹²⁶ Commission services' estimates

¹²⁷ FECIF data

¹²⁸ Commission services' estimates

costs related certification of translations:	<i>procedure and othe administartive costs related to cross border business in place, the estimated business as usual cost is 50% of the total costs.</i>
The declaration procedure (the cost of declaration and cots of business cards)	<p><i>For a travel agent company a €25 as one-off declaration cost and a one-off maximum of €600 costs for buying / adjusting IT equipment, printing, distributing business cards to comply with new obligations (the estimated business as usual costs id 95% of the total costs)</i></p> <p><i>For a car rental or leasing company a €25 as one-off declaration cost and a maximum of around one-off €600 costs for buying / adjusting IT equipment, printing, distributing business cards to comply with new obligations (the estimated business as usual costs is 95% of total costs)</i></p>
Training costs for those who fall under declaration procedure	<p><i>For travel agents : a €25 yearly costs ((the estimated business as usual costs is 95% of total costs (€500)).</i></p> <p><i>For car rentals: a €10 costs per year (the estimated business as usual costs is 95% of total costs (€200)).</i></p>

Administrative burden

Considering the above input, the Commission Services estimate the actual administrative burden of the proposed measures to around **617 EUR millions (aggregated estimate)** for the first year of application of IMD2, out of which 18 % is a one-off cost and the rest is a recurring cost per year. This was calculated based on the administrative costs calculation and estimations of business as usual costs (see explanation above). There are around 841,000 undertakings which will fall under the application of IMD2. (due to lack of data, claim handlers are not included in this figure).

This would result in an **administrative burden per undertaking of around 730 EUR**. These costs will not affect all the undertakings/persons in an equal manner since only those which are selling life insurance products with investment elements (intermediaries, insurers, banks) will have to comply with more stringent rules. (according to the preferred option to introduce MiFID-like regime for sellers of PRIPs insurances, see 7.2.) These undertakings are selling expensive and complex products with high expected return therefore they will be affected in a disproportionate manner.

The Gross Written Premium¹²⁹ (GWP) (life and non-life) for 2009 is 996 449 000 000 EUR. The estimated administrative burden for the first year of application of IMD2 represents around **0,06 % of the total GWP** of the insurance sector.

Administrative burden can be reduced if the implementation is done in conjunction with other changes (notably MiFID2). Those who sell investment products (banc-assurances, insurers, banks, some intermediaries) already comply with MiFID rules.

Annex 10 and 11 contains a detailed analysis of the possible administrative cost and burden associated with the preferred options identified for this initiative. Annex 11 also shows the administrative burden estimations for introducing revised MiFID-like regime based only on the conduct of business rules for intermediaries, insurance companies and banks.

Implementation cost per Member State

The implementation costs for Member States is estimated to be around 20 000 EUR per Member State. This figure is based on the responses of Member States to stakeholder surveys.¹³⁰

8.6. Overview of costs on the basis of the preferred options in million EUR

<i>Costs on the basis of the preferred options in million EUR (one-off costs)</i>				
	Compliance costs			
	From 0 to IMD2 (total)	From IMD1-IMD2	<i>thereof</i> Substantive costs	<i>thereof</i> Administrative burden
Extension of scope	240	3	2	1
Business card solution and remuneration disclosure	168	168	10	158
Introduction of MiFID-like rules	450	450	50	400
Professional qualification (training)	212	85	35	50

¹²⁹ Total premiums that the insurance company will collect over the duration of an insurance policy
¹³⁰ Study on the costs and benefits of different policy options for mortgage credit, London Economics with Achim Dübel (Finpolconsult) in association with the institute für finanzdienstleistungen (iff), November 2009.

Mutual recognition– Simpler notification procedure– Centralised registration EIOPA by	60	10	3	7
Total	1,130	716	100	616

For details on the calculation, please see Annex 18. For ongoing costs calculation, please see Annex 19.

Short explanation to the table:

From 0 to IMD2: it shows the total costs of implementing IMD2 from scratch, disregarding that IMD 1 is already in place.

From IMD1 to IMD2: total upgrading costs from IMD1 to IMD2

Substantive costs are induced by obligations for businesses to change their products and/or production processes.

Administrative costs/ administrative burden: The administrative costs consist of two different cost components: the business-as-usual costs and administrative burdens. While the business-as-usual costs correspond to the costs resulting from collecting and processing information which would be done by an entity even in the absence of the legislation, the administrative burdens stem from the part of the process which is done solely because of a legal obligation.

8.7. Estimation of benefits

By reducing conflicts of interest between insurance intermediaries and consumers, and by strengthening the rules against biased advice, there will be a better match between consumer's needs and products purchased. The policy options chosen in this impact assessment will lead to a situation where the product purchased by the consumer is better suited to his/her needs as well as his/her financial and personal circumstances. The increased consumer confidence should lead to better integration of the internal market and more financial stability in the aftermath of the financial crisis.

8.7.1. Quantitative approach to the calculation of the benefits

The consumer needs to buy insurance policies which fit his needs and financial situation. Otherwise, there is a real risk that he may not be covered in the event of a claim, or may cease to pay the premiums with a consequent default and cancellation if the policy is a life insurance, with consequent consumer dissatisfaction. For an insurance product with an investment element, a mis-sale can also involve getting the 'wrong' risk profile, which can mean a loss on a contract which would not have been sold if the customer's risk profile had been correctly assessed. A consumer who defaults on an insurance contract would incur a tax liability. In the variable annuity market, statistics suggest that in about 25% of cases consumers default.

The benefits to consumers and society as a whole from the introduction of high and harmonised advice standards come through a reduction in defaults and mis-sales. Different policy options have been examined in the light of their potential effect on the numbers. For instance, improved quality of advice at the point of sale of some complex insurance products should lead to an important reduction of mis-selling. The full methodology for the calculation of benefits can be found in Annex 11. The estimated impact of policy options on the level of defaults has been examined by the Commission Services on the basis of stakeholders' contributions and the evidence collected during the public consultation. Currently there are no market-wide figures that show how many defaults and lapses have occurred per year in the insurance sector as a whole.

The consumer detriment stemming from the lack of suitable advice for the sale of insurance products with investment element could, as indicated before, reach a very high figure, especially in times of financial crisis and uncertainty in the financial markets. Therefore, the benefits of a more stringent regime and increased consumer protection standards can be calculated on the basis of a reduction of the consumer detriment. Since it could reach **up to €1 trillion for EU 27**¹³¹, only for the sale of unit-linked insurance products, it could be assumed that even if a small percentage of reduction of consumer detriment could be attributed to improved regulatory standards, it will still represent a very high figure of benefits which overpass largely the administrative burden of the proposal. Similarly, in regard to PRIPs, UK FSA figures highlight the scale of potential consumer detriment: in the UK alone for one particular product this was estimated at £92m, owing to up to 20% of sales being influenced by factors other than the relative suitability of the different products¹³².

8.7.2. *Qualitative approach to the calculation of the benefits*

8.7.3. *Improved choice of insurance products for consumers*

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 better placed to compare offers and shop around for products and deals better suited to their needs. This should increase competition between the sellers of similar insurance products and reduce the cost/price paid by the consumer. Such benefits are not quantifiable due to the lack of data on consumer behaviour, price elasticity, etc.

¹³¹ Calculation based on the Impact assessment on PRIPs. Insurance Europe (former CEA) data from 2008 shows insurers hold overall investments in the range of €6 trillion (these investments cover savings and pensions, and some will be institutional holdings of funds such as UCITS; around a third can be estimated to be held as unit-linked life insurance). Therefore, if €2 trillion is allocated to unit-linked life insurance and around 57 % of it is sold without suitable advice, the potential consumer detriment stemming out of the sale of unsuitable unit-linked life insurance products could be estimated to be close to €1.1 trillion for EU 27.

¹³² Charles Rivers Associates (2005) and FSA calculations assessed recommendations of investment bonds (an investment product that involves life assurance) against those of a tax efficient, MiFID-scope product (equity ISAs). Despite already having in place some of the additional investor protection measures in MiFID for insurance-based investments bonds, the differential remuneration available to firms for selling the different products has been put forward as the cause of 12-20% of sales being assessed as unsuitable (see Annex 1 of Policy Statement 10/6 Distribution of retail investments, http://www.fsa.gov.uk/pubs/policy/ps10_06.pdf)

8.7.3.1. Greater business opportunities 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. Quantification of these benefits has not been possible due to the lack of relevant data. The extended scope of application of the IMD to include all sellers of insurance products (travel agents, car rental/leasing companies and direct writers) will provide an enhanced level playing field for all market participants.

8.7.3.2. Reduced costs for sellers of insurance products

As a result 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.

Benefit stemming from consistency with MiFID - increased consumer protection for insurance-based investments – a benefit for consumers, market players, and for Member States (regulators, supervisors)

There are areas where MiFID requirements are much stronger than in IMD1, therefore the following benefits can be expected: as regards **conflicts of interest management** consumer protection could be materially increased by stopping firms from operating their businesses in ways that conflict with the interests of their clients.¹³³ With regards to **clients interests**, this will provides regulator/supervisors with a clearly articulated standard to judge firms against. As far as **inducements** are concerned, the MiFID standard for the sales of insurance PRIPs is significantly higher in that it bans various payments and benefits. Both the consumer and the market player would benefit from greater transparency and similar rules when they buy/sell investment based products.

As for introducing a **suitability test**, consumer protection will be enhanced in Member States where no protection currently exists by making firms take responsibility for the advice that they give. It was also suggested by a study in the UK that applying one, MiFID-driven, suitability requirement to advisers selling all types of investment products¹³⁴ will be beneficial to firms, not just consumers, as they did not want the confusion of multiple standards. As regard incorporating an **appropriateness test**, this may involve additional time and cost, but as it is only done for complex products, costs should be proportionate to benefits. For instance, after MiFID was implemented, the UK FSA found evidence of potential benefits to vulnerable consumers “through a better highlighting and reinforced disclosure of

¹³³ Financial Services Authority, *CP07/23 Organisational systems and controls – extending the common platform*, December 2007 http://www.fsa.gov.uk/pubs/cp/cp07_23.pdf

¹³⁴ Financial Services Authority, *Conduct of Business sourcebook (COBS) post-implementation review: 2008 statement on interim findings (December 2008)*

relevant risks by means of questions asked of clients, warnings given and the encouragement firms give clients to access information they make available”¹³⁵.

In conclusion, costs are outweighed by the consumer benefits linked to more transparency on remuneration, less conflicts of interest, stringent rules on inducements, better quality of financial advice, less defaults on life insurance policies, improved consumer confidence (PRIPs).

9. MONITORING AND EVALUATION

The monitoring and evaluation of the preferred policy options will be carried out in 3 steps (1) a transposition/transitional period plan, in cooperation with EIOPA, preparing for the application of the rules; (2) the regular monitoring activity by the Commission, as guardian of the Treaty (focusing on the empowerment of national supervisors) and the national authorities. EIOPA would prepare a report on supervisory issues; and (3) the evaluation of the policy.

A full evaluation of the effects of the policy choices could, however, only be undertaken in the longer term. Some of the important policy choices will take time to have any impact e.g. remuneration disclosure, information requirements, European business card, stricter rules for selling insurance PRIPs, etc.). It would be necessary to carry out such evaluation: a preliminary examination by EIOPA (possibly followed by an interim report by the Commission), on selected issues: e.g. changes in insurance market structure; changes in the patterns of cross-border activity; interim assessment of the improvement in quality of advice and selling methods; impact of the changes regarding SMEs.

The evaluation of the consequences of the application of this Directive will also take place five years after the transposition date for the legislative measure, in the context of a report to the Council and the Parliament. The report will be produced by the Commission following the above mentioned consultation of the European Insurance and Occupational pension Authority (EIOPA). Key elements of such a report would assess in how far market structures have changed in the EU following the implementation of the IMD Review; how the potential conflicts of interest have been solved; and how the cost of operating for market participants has changed due to the measures implemented.

The main indicators and sources of information that could be used in the evaluation process are as follows:

- experience regarding the measures designed to strengthen consumer protection; estimate of the impact on the market of the new consumer protection rules (disclosure rules on remuneration, information requirements, European business card, etc.); impact indicators should be the number and level of complaints in the EU; mis-selling scandals as opposed to numbers and levels set out before the entry into force of IMD2; and the number and severity of cases where consumers, in general, and retail investors, in particular, have

¹³⁵

Financial Services Authority, Conduct of Business sourcebook (COBS) post-implementation review: 2008 statement on interim findings (December 2008)

suffered losses (sources: stakeholders feedback, general, already existing supervisory reporting);

- progress made in achieving undistorted competition: impact indicators should be the number of complaints received by regulators and supervisor; and competition cases at national and EU level (sources: stakeholders feedback, reports from national competition authorities and DG COMP);
- experience how certain provisions are applied in practice, (e.g. regime for disclosure on remuneration), indicators should be the level of bad application cases and complaints (source: mystery shopping to assess compliance, supervisory monitoring);
- developments on enhanced cross-border business, indicators should be the change in number of businesses providing cross-border services (sources: statistics from competent authorities);
- experience with third country regimes and a stock-taking of the number and type of third country participants granted access, impact indicators should be the uptake of third country firms of the new regime and the supervisory experience in practice with such firms;
- regulatory coherence, impact indicators should be the cases of known regulatory arbitrages (sources: baseline survey and follow-up survey in 5 years);
- impact of the proposed measures in the general insurance, and insurance investment markets, impact indicator should be the change in the price of premiums in both general insurance and insurance investment markets following implementation of the IMD Review.