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Position Paper on the recast of the Insurance Mediation Directive

The Financial Services Consumer Panel is an independent statutory body, set up to represent the interests of consumers in the development of policy for the regulation of financial services in the UK. We are listed on the EU's Transparency Register, and we work closely together with other consumer organisations throughout Europe.

In view of the start of the trilogue negotiations on the recast of the Insurance Mediation Directive in January 2015, the Panel has developed this position paper to take into account the proposals put forward by both the European Parliament and the Council, focusing on provisions that, in our view, raise particular challenges.

We have a number of concerns about the amendments proposed, which we outline in the paper. In some cases, such as the ban on commission for independent advisers on insurance-based investment products, we believe the original Commission proposal should be reinstated.

We support the Parliament's changes as regards the powers of alternative dispute resolution (ADR) entities and the ban on tying of products, which we feel are in the consumer interest. Conversely, we would urge MEPs to support the Council's position in its general approach on the introduction of a basic regime for ancillary insurers that are out of scope.

Our position on these and other issues are set out in more detail below. If the Panel can be of any assistance, or elaborate further on any of the issues raised, please do not hesitate to contact us.

Sincerely,



Sue Lewis
Chair
Financial Services Consumer Panel

Position Paper on the recast of the Insurance Mediation Directive

Unless indicated otherwise, this position paper is based on the European Commission's original proposal of 3 July 2012¹, the European Parliament partial first reading agreement of 26 February 2014² and the Council's general approach of 7 November 2014³.

Article 1: Scope of the Directive (ancillary intermediaries)

The Panel has concerns about the scope of Directive as proposed by the Commission and supported by the European Parliament in article 1. In our view, the derogations listed in article 1(2) would lead to the exemption of too many ancillary intermediaries. The article appears to us to be overly broad, reducing protection for many consumers without justification.

We support the introduction of article 1(2b) in the Council's general approach, which will make all ancillary insurers, even those covered by the exemption of article 1(2), subject to basic rules on provision of information, conduct of business and complaints procedures. We strongly urge the Parliament to agree to these changes.

In our view, article 1(2b(b)) of the Council text could be improved further by including an explicit reference to article 15b(2), which would have the effect of requiring all ancillary insurers to comply at a minimum with new rules on informing customers about the terms and conditions of a policy prior to sale.

However, we do not support the Council's proposal for a partial exemption for certain types of ancillary insurance related to services, such as travel insurance. No clear rationale is provided for such an exemption and in our view such sales should be covered by the new Directive.

- **Recommendation 1:** Include ancillary insurance for services provided within the scope of the Directive by rejecting article 1(2a)(a) of the Council general approach
- **Recommendation 2:** Maintain article 1(2)(b) of the Council's general approach to establish a basic regime for ancillary insurers out of scope of the Directive. This basic regime should include adherence to article 15b(2) of the general approach, entitling consumers to information about terms and conditions prior to sale

Article 5: Freedom to provide services

We reiterate our long-standing concerns about the consequences of the EU passporting rules on freedom to provide services. While this undoubtedly facilitates access to national markets, in the case of the Insurance Mediation Directive we have serious concerns that the rules will encourage regulatory arbitrage in view of the minimum level of harmonisation sought for within the Directive.

Whilst the Panel welcomes the anti-abuse clause introduced by the Council in article 7c of its general approach, we question whether this will be sufficient to deter regulatory arbitrage. In particular, the different levels of resources available to the various national competent authorities are likely to complicate effective enforcement of the Directive and transposing legislation, in particular in less well-developed markets.

¹ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012PC0360&from=EN>

² <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2f%2fEP%2f%2fTEXT%2bTA%2bP7-TA-2014-0155%2b0%2bDOC%2bXML%2bV0%2f%2fEN&language=EN>

³ <http://data.consilium.europa.eu/doc/document/ST-14791-2014-REV-1/en/pdf>

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The co-legislators should consider strengthening the provisions on the division of competences between home and host Member States to ensure that an intermediary which is principally active in a single national market should be supervised as if that country was its home Member State.

- **Recommendation 3:** Ensure that an intermediary principally active in one Member State is subject to home country supervision in that Member State, to avoid regulatory arbitrage

Article 13: Alternative Dispute Resolution

The Consumer Panel was extremely concerned by the inclusion in the original Commission proposal of article 13 on out-of-court redress, which would have prohibited the UK's Financial Ombudsman Service (FOS) from making binding decisions in favour of consumers.

We are pleased that the Parliament has taken the position that such decisions 'may be binding'. The Council has removed article 13 altogether. Both amendments safeguard the current powers of the FOS, and the Panel could therefore support either approach.

However, as a general principle we do support inclusion of a reference to alternative dispute resolution in financial services legislation. Naturally, this should leave individual Member States the option to make ADR decisions binding.

EU legislation could nonetheless impose a consistent approach to other aspects of dispute resolution, notably the need to safeguard the independence of ADR schemes from industry (as the ADR Directive does permit in-house arbitration), and provision of information to consumers on the existence of redress schemes. In the long run, this would ensure higher standards of out-of-court redress across the EU.

- **Recommendation 4:** Maintain the Parliament's wording of article 13 to ensure that individual Member States can let ADR entities make binding decisions in favour of the consumer

Articles 17 and 24: Commission and conflicts of interest

In the Panel's view, this article should be strengthened to ensure that certain toxic types of commission are banned entirely, as they can never be deemed to be in the best interest of the client. This includes, for example, remuneration linked to sales targets or the volume of claims lodged by customers.

Both Parliament and Council have removed the provision that the total amount of commission earned by the salesperson must be disclosed. The Panel believes the full amount of commission should be disclosed to let consumers ascertain whether the sum offered creates a conflict of interest for the intermediary. We call on the co-legislators to reinstate article 17(1)(f) and (g) of the original Commission proposal.

However, we note that for insurance-based investment products, the Council has sought consistency with MiFID 2 in explicitly requiring disclosure of the amount of the commission (article 24(7)(c)). We would urge the co-legislators to agree, at a minimum, to disclosure of the full amount in these cases to align the Directive with MiFID 2 and avoid regulatory arbitrage.

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Whilst the Parliament's position in article 24(3)(ba) may have the equivalent intended effect by referring to disclosure of 'any third-party payments', we would support the inclusion of a reference to the 'existence, nature and amount' of the third-party payment in this paragraph, for reasons of clarity. In absence of such a reference, distributors may interpret the disclosure requirement more flexibly.

- **Recommendation 5:** Include an explicit ban on types of commission that present inherent conflicts of interest, as these can never be in the interest of the customer
- **Recommendation 6:** Reinstate article 17(1)(f) and (g) of the original Commission proposal to ensure disclosure of the amount of commission paid
- **Recommendation 7:** Support the Council's article 24(7)(c) on disclosure of commission for insurance-based investment products

Article 21: Cross-selling

N.B. In the Parliament's text, this article has been renumbered 21a.

The original Commission proposal would ban "tying" insurance products to other products and services, mandating that the separate components are also made available to customers separately. The European Parliament has maintained this ban, although we are concerned about its wording in article 21a(1), which we consider unclear. In particular, the word "and" appears to be missing in between the words "separately" and "provide".

We cannot support the position of the Council, which has chosen to remove the ban on bundling altogether. Its text would instead merely oblige firms only to disclose whether the individual components of a package could also be bought unbundled & how much each component of a package costs, based on the MiFID 2 model.

There is no justification provided by the Council as to why insurers or intermediaries should be allowed to force consumers to purchase a package of good and/or services, or nothing at all. Like the Commission and Parliament, the Panel is of the view that tying practices distort competition and adversely affect the ability of consumers to make informed choices and switch between service providers.

Given the increase in problems reported in the UK with packaged bank accounts where consumers are sold insurance products as a condition of opening an account⁴, the Panel supports mandatory un-bundling. We call on the co-legislators to reinstate the Commission's original article 21, or to support the European Parliament's approach subject to a clarification of its article 21a(1).

- **Recommendation 8:** Support the ban on tying of products in the Parliament's text (article 21a), subject to a clarification of paragraph 1, and reject the Council's approach in article 21

⁴ <http://www.financial-ombudsman.org.uk/publications/ombudsman-news/112/112-packaged-accounts.html>

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We welcome the insertion of article 21a by the Council, enabling the Commission to adopt a binding delegated act on product oversight and governance (POG) rules for insurers and intermediaries. This will provide for a more robust framework at EU-level to ensure products are designed and marketed in a responsible way, addressing real consumer needs. We would urge EIOPA to begin preparatory work to amend its draft guidelines on POG as soon as is practicable.

- **Recommendation 9:** Support the inclusion of article 21a as proposed by the Council in its general approach

Article 24: Information to consumers (investment-based insurance products)

We were disappointed to see that both the Parliament and Council have removed the ban commission and inducements for independent intermediaries when selling insurance-based investment products (article 24(5)(b) of the original proposal). Such a ban would be an entirely sensible step to avoid conflicts of interest and prevent miss-selling. Similarly, for commission paid to intermediaries who are not independent, we believe that payments should be allowed only where they enhance the quality of the service provided.

While the Council has sought to qualify that any commission paid for investment-based insurance products must not have a 'detrimental effect' on the quality of the service, we have concerns that in practice this will not be enforceable. It is unclear to us why the MiFID 2 test, that commission must at a minimum 'enhance the quality of the service', should not apply to the sale of such products. We also believe that there should be a requirement for the firm to show how the commission enhances the service provided.

The Panel would also support the inclusion of Parliament's article 24(7), which enables the Commission to adopt a delegated act specifying *inter alia* what types of costs and charges must be disclosed. This is broadly in line with the approach taken under MiFID 2 (article 24(13)(b)), but the delegation is missing from the Council's text.

We have concerns that a lack of EU-wide criteria for disclosure of costs would leave firms with the flexibility to omit informing customers about certain hidden fees, an issue which we have discussed extensively in a recent report.⁵

Moreover, failure to align the definition of 'costs' in the context of disclosure with MiFID 2 would complicate transposition of the two Directives by the Member States, and likely lead to regulatory arbitrage as the disclosure requirements would be perceived to be less stringent under IMD 2 than under MiFID 2.

In a similar vein, we also note the lack of detail on how inducements should be treated as potential conflicts of interest. Under MiFID 2 (article 24(13)(d)), the European Commission will adopt a delegated act to assess whether inducements impair a firm's duty of care. We would expect a similar provision to be included in the IMD for reasons of consistency, but it missing from both the Parliament and Council text.

Reinstating the ban on commission for independent advisers and introducing further restrictions on detrimental types of inducements would largely align the recast Directive with the recently-adopted Markets in Financial Instruments Directive (MiFID 2), and prevent consumers from having lower standards of protection when purchasing investment-based insurance products compared to other investment products.

⁵ http://www.fs-cp.org.uk/publications/pdf/investment_discussion_paper_investment_cost_and_charges.pdf

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The Panel would also welcome clarification on whether the Parliament's article 24(5a) and the Council's article 24(12), which authorise Member States to go beyond the minimum requirements of the Directive, would be sufficient to permit the UK to continue to ban commission for independent advice for all investment products as part of the Retail Distribution Review (RDR).

- **Recommendation 10:** Reinstate the Commission's original article 24(5)(b) to ban commission for independent intermediaries selling insurance-based investment products
- **Recommendation 11:** Align all other types of commission for insurance-based investment products with article 24(9) of MiFID 2, meaning that such third-party payments must enhance the quality of the service provided
- **Recommendation 12:** Mandate the European Commission to adopt a delegated act on the types of costs and charges that must be disclosed, modelled on MiFID 2 article 24(13)(b)
- **Recommendation 13:** Mandate the European Commission to adopt a delegated act for criteria to be used in assessing whether inducements impair a firm's duty of care, modelled on MiFID 2 article 24(13)(d)

Article 25: Execution-only sales of investment-based insurance products

We are concerned that article 25(2a)(a) in the Parliament's text, on the execution-only sale of non-complex products, has not been drafted to ensure full alignment with MiFID 2.

MiFID 2 allows for execution-only sales without a suitability or appropriateness test for certain 'non-complex products', some of which are defined in the Directive, while legally-binding criteria for assessing whether other products fall into this category will be developed by the Commission based on technical advice provided by ESMA.

In the Parliament text for the new IMD, no explicit delegation of this power to the Commission exists. Instead, there is only an instruction for EIOPA to develop non-binding guidelines (article 25(5a)). For reasons of legal clarity, we would support inclusion of the Council's version of article 25(5), which contains an explicit mandate for the Commission to adopt a delegated act on criteria for assessing the complexity of products covered by the chapter on investment-based insurance products.

The Panel would also urge the co-legislators to clarify whether the approach chosen could lead to products being considered 'complex' under MiFID 2 but 'non-complex' under the recast IMD, and the possibility of regulatory arbitrage this entails.

- **Recommendation 14:** Support the Council's text for article 25(5) to mandate the European Commission to adopt a delegated act on criteria for assessing the complexity of investment-based insurance products which are sold on an execution-only basis