

PREPARING FOR THE IMPLEMENTATION OF THE INSURANCE DISTRIBUTION DIRECTIVE

The Insurance Distribution Directive¹ ("IDD") is due to come into force on 23 February 2018 and will impact the distribution of insurance and reinsurance across the European Union, replacing the current insurance mediation directive² ("IMD").

There have been calls for the delay of its implementation by the insurance and insurance distribution industry, as well as by the European Parliament's Committee on Economic and Monetary Affairs ("ECON"). Pending any decision to delay, Member States are in the process of implementing the IDD into their local law, including the UK where the FCA has published various consultation papers and a policy statement which indicates the way in which the IDD is likely to affect the distribution of insurance in the UK. The implementation of the IDD in the longer term (along with all other EU based legislation) may of course be impacted by Brexit. However, the UK Treasury has reiterated that until Brexit negotiations are concluded, it will negotiate, implement and apply EU legislation and so intends to implement the IDD on time.

This briefing note summarises, at a high level, the IDD requirements and the position the UK intends to adopt. It also supplements and updates our previous briefings dated [September 2015 \(Near Final: the Insurance Distribution Directive\)](#) and [June 2016 \(MiFID II & IDD: The impact on insurance based investment products\)](#).

Scope (Chapter I IDD)

EU: The IDD applies to persons who distribute insurance and broadly, this means firms who sell, advise on, or conclude insurance contracts, and those who assist in administering or performing insurance contracts. Typically these are insurers, insurance brokers and other operators or retailers who provide insurance alongside their primary business.

The IDD also expressly applies to certain activities conducted through aggregator or price comparison websites and introduces ancillary insurance intermediaries ("AI") as a new type of intermediary. AIs will be caught by the IDD unless their activities fall within the connected contracts exemption ("CCE"). See our briefing note ["Near Final: the Insurance Distribution Directive"](#) for further information on the scope of the IDD and the CCE.

UK: To a large extent, the existing UK rules reflect the IDD requirements. As such, the UK intends to rely on these rules to extent possible to minimise changes and to the extent these to cover the minimum requirements of the

OVERVIEW

Who does it apply to?

The IDD affects all insurance and reinsurance distributors, including AIs, banks in bancassurance arrangements and website aggregators.

What does it cover?

Whilst the IMD applies only to insurance intermediaries, the IDD covers all participants in the distribution of insurance, including direct sales by (re)insurers.

The IDD sets out a legal and regulatory framework for (re)insurance distribution including:

- a registration/authorisation and passporting framework
- professional requirements and certification
- product information/ disclosure requirements and conduct of business rules
- product oversight and governance requirements

Preparing for the IDD

The IDD is minimum harmonising, meaning that it sets out minimum rules to be complied with but Member States are free to implement additional requirements (which is the approach the UK has adopted). The impact of IDD on insurance distribution across Europe will therefore depend on the local implementation. Unless the implementation of the IDD is delayed, it is due to come into force in February 2018. Insurance distributions should therefore be aware of the key changes that are likely and consider how those changes may impact their business operations, as well as policy terms and conditions and product disclosures.

¹ Directive (EU) 2016/97

² Directive 2002/92/EC of 9 December 2002 on insurance mediation

IDD where relevant. These include the application of the relevant insurance mediation rules to insurance undertakings and the extension of certain conduct of business rules to the distribution of large risks and to intermediaries who are not in direct contact with the customer.

Registration and Passporting (Chapters II & III IDD)

EU: Like the IMD, the IDD continues to require (re)insurance intermediaries to be registered by an authority in their 'home Member State' and extends this requirement to AIs. Intermediaries that are already registered in Member States (under the IMD) should not need to register again under the IDD. However, firms which are not currently registered as intermediaries will need to determine whether they fall within the scope of the IDD, whether as an intermediary or an AI.

Once registered as an intermediary, a firm will be able to exercise the right to passport (on a branches or services basis) into other Member States.

UK: The IDD does not substantively change the UK position on registration or authorisation/licensing. At present, (re)insurance intermediaries must apply to the FCA to be registered as an intermediary.

Professional & organisational requirements (Chapter IV IDD)

EU: The IDD sets out minimum professional knowledge and competence requirements for intermediaries and employees of both (re)insurers and intermediaries. The minimum requirements include knowledge of policy terms and conditions, applicable laws, claims and complaints handling, and ethics standards. To that end, Member States are required to ensure that intermediaries, and employees of (re)insurers and intermediaries, comply with the minimum annual 15 hour continuing professional development ("**CPD**") requirements and to maintain an adequate level of performance corresponding to both the role they perform and the relevant market. This training and development could encompass various types of facilitated learning opportunities including courses, e-learning and mentoring.

The IDD also requires intermediaries to hold Professional Indemnity Insurance ("**PII**") or a comparable guarantee against liability arising from professional negligence. The minimum levels of PII cover required are €1,250,000 per claim per year, and €1,850,000 per year in aggregate.

Separately, the IDD requires firms to put in place a process for handling complaints from all customers. There is a further requirement for out-of-court redress procedures to be available to customers in accordance with other EU legislation. The IDD places responsibility on the home Member State to ensure that complaints and out-of-court redress processes are available to customers.

UK: In the UK, firms are currently required to ensure their employees have the knowledge, skills and expertise necessary to carry out their responsibilities, including compliance with CPD requirements, some of which will go beyond the IDD requirements. These requirements will be maintained and will be extended where relevant.

In respect of PII, the UK already requires PII to be in place which will broadly remain unchanged, but with the new IDD minimum level.

EEA branches of UK firms will also be required to put in place a complaints

Key new terms

- **(Re)insurance Distribution** means the activities of advising on, proposing or carrying out other work preparatory to the conclusion of contracts of (re)insurance, concluding such contracts or assisting in the administration and performance of such contracts, in particular in the event of a claim.
- **(Re)insurance Distributor** means any (re)insurance intermediary, ancillary insurance intermediary or (re)insurance undertaking.
- **Ancillary Insurance Intermediary (AI)** means any natural or legal person (other than a credit institution or investment firm), who for remuneration, takes up or pursues the activity of insurance distribution on an ancillary basis provided that (i) the principal professional activity is other than insurance distribution; (ii) the insurance products distributed are complementary to a good or service; and (iii) the insurance products concerned do not cover life assurance or liability risks, unless that cover complements the good or service which the intermediary provides.
- **Insurance Manufacturer** means manufacturers of insurance products and includes (re)insurance intermediaries where, from an overall analysis of the intermediary's activity on a case-by-case basis, such (re)insurance intermediary appears to autonomously decide on the essential features and main elements of an insurance product, including the coverage, costs, risk, target market or compensation or guarantee rights.

process and recourse to an Alternative Dispute Resolution Directive entity in the relevant host states to resolve consumer disputes.

Information requirements and conduct of business rules (Chapter V IDD)

EU: The IDD introduces general conduct principles that apply to all insurance distributors. In summary, the IDD general principles provides that firms must act honestly, fairly and professionally in accordance with their customers' best interests and firms must communicate in a way which is clear, fair and not misleading and marketing materials must be clearly identifiable as such. Further, remuneration of a firm or its employees, and performance management of employees, must not conflict with the duty to act in accordance with their customers' best interests.

UK: Although the UK already requires a firm to act in its client's best interests, the rules will be updated to comply with the IDD's conduct requirements. In particular, the FCA will introduce a new rule requiring insurance distributors to act honestly, fairly and professionally in accordance with the best interests of their customers ("**the customer's best interest rule**"). Additionally, all marketing communications must be clearly identifiable as such. Remuneration and performance management practices that would conflict with the customer's best interests rule will also be prohibited.

Demands and Needs

EU: Prior to the conclusion of any insurance contract (including insurance products that are offered together with an ancillary product or service which is not insurance), regardless of whether advice is provided, the insurance distributor must (i) specify the demands and needs of that customer (based on information obtained from the customer), (ii) provide the customer with objective information about the insurance product and (iii) ensure that any insurance product proposed to the customer is consistent with the customer's demands and needs. Where advice is provided prior to concluding the insurance contract, the distributor must provide the customer with a personalised recommendation explaining why a particular product would best meet the customer's demands and needs.

UK: In implementing the demands and needs requirements into the UK rules, the FCA has provided guidance on what it expects the firms to do in practice. It sets out a two-step process, which should be taken early on in the sales process, whereby the distributor must first identify the customer's demands and needs and match them to available products and secondly state the customer's demands and needs to assist them in making an informed decision. In relation to non-advised sales, the FCA does not expect distributors to carry out a detailed investigation of the customer's circumstances but should nonetheless identify their demand and needs.

FCA Example:

A distributor who sells motor insurance on a non-advised basis should ask the customer the level of cover they require, amount of excess they are prepared to pay and the type/amount of their driving. The distributor should then limit their product offering to those which would meet these specified demands and needs.

The IPID

EU: For non-life insurance products, pre-contractual disclosures must be provided in the form of a standardised Insurance Product Information Document ("**IPID**"), the form of which has been specified by the European Commission. It must contain specific content including a summary of the insurance cover, the main risks insured, the insured sum and, where applicable, the geographical scope and a summary of the excluded risks.

UK: The IPID disclosures are similar to the current UK requirements for a summary policy document, however, the IPID format will need to be adopted for the distribution of non-life products in the UK as the IPID Implementing Regulation³ is directly applicable in Member States. In addition, the FCA has also specified that additional pre-contractual disclosures may also need to be made albeit in a separate document, for example in relation to the demands and needs statements.

Disclosure of Remuneration

EU: As part of the pre-contractual disclosures, customers need to be informed of the "**nature**" and "**basis**" of remuneration in relation to their insurance contract. The IDD permits disclosure by method of calculation instead of the actual amount where the amount cannot be calculated at the time.

³ EU 2017/1469 on 11 August 2017 laying down a standardised presentation format for the insurance product information document.

UK: With respect to disclosure of remuneration, the FCA has interpreted that "**nature**" and "**basis**" require distributors to disclose, respectively, the type of remuneration they will receive or pay (such as a basic commission, bonus, profit share or other financial incentive) and the source of remuneration received (i.e. if on a basis of a fee, the remuneration paid directly by the customer, or in on the basis of a commission, the remuneration included in the insurance premium).

FCA's illustrative examples:

- ✗ *"Insurers pay us commission to sell policies on their behalf. They also provide us with periodic incentives (such as bonus payments) if we meet certain sales targets" - this does not state the basis or source of the remuneration*
- ✓ *"We arrange the policy with the insurer on your behalf. You do not pay us a fee for doing this. We receive commission from the insurer which is a percentage of the total annual premium."*
- ✗ *"We receive commission from the insurer for selling this policy." - this does not state the basis or source of the remuneration*
- ✓ *"When you take out a policy with us we charge you a fee of £50. In addition, the insurer pays us a percentage of the annual premium 14 days after the policy starts."*

Product Oversight and Governance

EU: The IDD requires insurance manufacturers to maintain, operate and review a product approval process for newly developed insurance products, or significant adaptations of an existing insurance product. The approval process must contain measures and procedures for designing, monitoring, reviewing and distributing insurance products and include corrective action for insurance products that are detrimental to customers. As part of this, a target market should be identified for each insurance product.

UK: The FCA intends to amend the current rules to take into account the requirements under the Commission's product oversight and governance regulation⁴ and will introduce new guidance to help firms understand the FCA's expectations of the IDD requirements such as (i) cases where distributors have a role in product manufacture; (ii) target market assessment; (iii) product testing; and (iv) ongoing product reviews.

Cross-selling

EU: Where an insurance product is bundled / offered together with an ancillary product or service which is not insurance as part of a package or the same agreement, the insurance distributor must inform the customer whether it is possible to buy the different components separately, and if so, must provide an adequate description of the difference components and costs. Where the insurance product is ancillary to a good or service that is not insurance, the insurance distributor must offer the customer the possibility of buying the good or service separately.

UK: The FCA intends to update the UK rules to reflect the IDD requirements. Existing pre-contractual disclosure requirements and the prohibition on opt-out selling will continue to apply.

Conflicts of interests

The IDD imposes requirements to prevent conflicts of interest for all insurance products, including a higher standard for investment based insurance products ("**IBIPs**"). These higher standards are set out in our note titled "products" and are broadly, consistent with existing UK requirements. In order to maintain the current position, the FCA proposes to extend these higher IDD requirements to all types of insurance, rather than just to IBIPs.

REQUIREMENTS RELATING TO INVESTMENT BASED INSURANCE PRODUCTS ("**IBIPs**") (CHAPTER VI IDD)

The IDD introduces enhanced conduct requirements for IBIPs which are, generally, life insurance products with investment elements. The intention behind these enhanced requirements is to more closely align the customer protections for such products with those provided by the Markets in Financial Instruments Directive II ("**MiFID II**"). Please see our note titled "[MiFID II & IDD: The impact on insurance based investment products](#)" for further information.

⁴ Commission Delegated Regulation (2017/ 6218)

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