EFAMA's comments on the EIOPA's Consultation Paper on Technical Advice on possible delegated acts concerning the Insurance Distribution Directive [EIOPA CP 16/006]

Introductory comments

EFAMA[1] welcomes the opportunity to comment on EIOPA's draft suggestions for the technical implementation of the Insurance Distribution Directive (IDD).

We agree with the approach described in the Commission's mandate that alignment with the MiFID II regime should be sought in every area in which there is no fundamental difference in the wording of the parallel provisions in the IDD and MiFID II. We agree that, given the substitutability of products covered by IDD and by MiFID II, the starting point should be alignment between the two sets of requirements unless differences in the Level-1 texts exist and there are clearly justifiable reasons for reasons of investor protection to create diverging approaches. In our view, the draft Technical Advice presented by EIOPA strikes the right balance between accounting for peculiarities of insurance products and distribution models on the one hand and striving for consistency with MiFID II in specific wording, or at least in the quality of regulation, on the other. We highly appreciate the efforts dedicated to this challenging exercise and strongly support and encourage EIOPA to remain committed to this general approach.

Delegated acts are not foreseen for every relevant aspect of the IDD regime, thus requiring EIOPA's further efforts. Especially with regards to information about costs the Level-1 framework does not explicitly mandate specification of further requirements at Level-2. Nonetheless, since the wording of the relevant Article 29(1)(c) and second subparagraph of IDD on cost disclosure is nearly identical with the wording of Article 24(4)(c) and second subparagraph of MiFID II, we see no justifiable reason why EIOPA should not continue to work towards further detailed alignment by appropriate Level-3 measures.

[1] **EFAMA** is the representative association for the European investment management industry. EFAMA represents through its 26 member associations and 61 corporate members EUR 21 trillion in assets under management of which EUR 12.6 trillion managed by 56,000 investment funds at end 2015. Just over 30,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 25,900 funds composed of AIFs (Alternative Investment Funds). For more information about EFAMA, please visit www.efama.org

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1. What would you estimate as the costs and benefits of the possible changes outlined in this Consultation? Where possible, please provide estimates of one-off and ongoing costs of change, in Euros and relative to your turnover as relevant. If you have evidence on potential benefits of the possible changes, please consider both the short and longer term. As far as possible, please link the costs and benefits you identify to the possible changes that would drive these.

No comment

2. Do you agree that the policy proposals above provide sufficient detail on product oversight and governance arrangements?

We support EIOPA's approach, analogue to MiFID II, to separate the product oversight and governance arrangements between insurance undertakings and insurance intermediaries which manufacture products and insurance distributors simply advising or proposing such products.

Nevertheless, one major difference we discovered in relation to the target market concept relates to EIOPA's suggestion that the distribution shall allow the product to be sold outside the target market as defined by the manufacturers only in exceptional circumstances (paras. 52-54 on pages 20-21 and para. 34 of the draft Technical Advice). We believe that this approach might hinder insurance distributors to fully account for the specific needs and individual characteristics of their clients when advising on, or selling, insurance products and thus would suggest further alignment with the concept proposed under MiFID II's target market.

We are aware that EIOPA takes a view which is slightly different from MiFID II as regards allocation of responsibilities for product governance and target market definition between product manufacturers and distributors. In particular, insurance distributors shall not be required (or allowed) to make their own assessment of the target market. While this difference is understandable in principle given the divergences in regulation of distribution channels under MiFID II and IDD and its respective linkage to product manufacturers, it means, however, that insurance distributors will need to rely on the target market definition specified by the product manufacturer, even though the distributor is the one in contact with the individual client and able to assess the suitability of the specific product.

Definition of the target market by the manufacturer will by nature be made in abstract terms and without knowing, or being able to account for, the needs and characteristics of individual clients at the point of sale, but based on categories of clients. In these circumstances, it must be anticipated that the target market definition will not cover each and every situation in which a product might be of reasonable use for an individual. Furthermore, the regulatory aim of the target market concept is to ensure that manufacturers design products according to customers' needs in order to strengthen their responsibility. This concept should, however, not limit the responsibility of the distributor in assessing whether a product fits a specific customer. Rather, the distributor should understand the target market and be able to assess individually whether a product in specific circumstances is suitable for an individual client despite the fact that the client might not be within the target market. In addition, should the distributor not be allowed to sell outside the target market, the manufacturer is deprived

of the chance to adjust the target market according to distributors' experience. Therefore, it appears important that insurance distributors are granted appropriate leeway for proper performance of suitability or appropriateness tests for individual clients without being restricted by the abstract target market definition. At the very least, insurance distributors should be able to allow for sales outside the target market in their distribution strategies based on the assessment of the overall individual situation and existing investments and obligations of a customer and a positive outcome of suitability testing for a product.

We note some considerations in this respect in the analysis supplementing the draft Technical Advice (para. 52-54 on pages 20-21). However, given the legal risks corresponding with the distribution outside the specified target market, it would be helpful if a respective clarification could be provided in the text of the Technical Advice itself, specifically by an addition to para. 34 on page 26.

Furthermore, we would like to provide the following more technical comments on better aligning the draft advice (page 21-26) with MiFID II's draft Implementing Directive:

Para. 1 on the definition of a product manufacturer should be further clarified along the lines of MiFID II's draft Implementing Directive [Art. 9(1)] by stating that manufacturing "encompasses the creation, development, issuance and/or design of financial instruments".

Para. 2 should include a reference to the "nature of the target market" in order to align the requirements with MiFID II's draft Implementing Directive [ibidem]:

> "The product oversight and governance arrangements need to be proportionate to the level of complexity and the risks related to the products ***and the nature of the target markets,*** as well as the nature, scale and complexity of the relevant business of the manufacturer."

Para. 28 should also include a reference to the "nature of the target market":

> "The product distribution arrangements need to be proportionate to the level of complexity and the risks related to the products ***and the nature of the target markets***, as well as the nature, scale and complexity of the relevant business of the insurance distributor."

3. Are there any further arrangements, except those outlined below, which you would consider necessary and important?

The interrelation between target market definitions under IDD and MiFID II is not addressed in the consultation paper at hand. **As regards insurance-based investment products, however, we consider it of utmost relevance that the target market criteria applicable under IDD are at least compatible with the MiFID II concept of a target market. Optimally, insurance undertakings offering e.g. unit-linked insurance contracts should be able to rely on the target market description provided under MiFID II rules in order to determine whether a fund complies with the target market defined at the level of the insurance product.**

Therefore, while appreciating that the draft technical advice is confined to general principles concerning target market identification, we would like to encourage EIOPA to work towards consistency in language with the relevant MiFID II and PRIIPs provisions. In particular, the criterion of "literacy" of the target market foreseen in para. 9 on page 22 should be replaced with "knowledge and experience" relevant under MiFID II. Similarly, the "degree of financial capability" could be reworded in "ability to bear losses" which applies to the description of the target investor according to PRIIPs.

In this context, it should be noted that ESMA is currently working on a set of criteria relevant to the target market specification under MiFID II which will take the form of Level-3 guidelines. A public consultation on ESMA's approach to this topic is expected to be launched in the coming weeks. We believe it important for EIOPA to closely monitor these developments and to liaise with ESMA in order to develop a common understanding of regulatory principles underlying the target market definition under both EU frameworks.

4. What costs will manufacturers and distributors face to meet these requirements? If possible, please estimate the costs through quantitative data.

No comment

5. Do you agree with the proposed high-level principle in order to assess whether activities of an insurance intermediary should be considered as manufacturing?

No comment

6. Do you consider that there is sufficient clarity regarding the collaboration between insurance undertakings and insurance intermediaries which are involved in the manufacturing of insurance products? If not, please provide details of how the collaboration should be established.

No comment

7. Do you agree with the proposed high-level principle for the granularity of the target market? If not, please provide details on the level of detail you would prefer.

We currently do not have any further comments on the granularity of the target market, as we are awaiting ESMA's MiFID II Level-3 guidelines on target market. We would, of course, value further alignment between the target market concepts once ESMA's guidelines have been finalised.

8. Do you agree with the proposed review obligations for manufacturers and distributors of insurance products? Would you consider it important to introduce a minimum frequency of reviews which should be undertaken by the product manufacturer e.g. every 3 years?

We do not consider that a minimum review frequency should be introduced. As EIOPA has stated in their draft Technical Advice, it should be left up to the manufacturer and distributor to determine how frequent the reviews should be made. This allows for a risk-based approach to the frequency of the review.

With regards to the requirement to "review obligations for insurance undertakings and insurance intermediaries which manufacture insurance products for sale to customers", we would like to provide the following comments:

In para. 2 of the draft Technical Advice, the reference to "size, scale", in connection with the product review frequency, should be changed to "nature" in order to better reflect the language used in MiFID II and to not unnecessarily limit insurance undertakings and insurance intermediaries in their assessment. We would propose the following:

> "The manufacturer should determine the frequency for the regular review of its products taking into account the ~~***size, scale***~~ ***nature*** and complexity of the different products it manufactures."

Furthermore, the requirement that the manufacturer and the distributor should have written agreements in place in order to coordinate their product reviews should be removed. For example when a bank acts as a distributor of both investment-based insurance products and financial instruments, it may want or need to take a holistic approach in regards to its periodic product governance review process. Requiring the distributor in this case to contractually align product reviews with the insurance manufacturer puts a disproportionate burden on the distributor as it could not aim to align review processes with manufacturers of e.g. financial instruments under MiFID II. It would hinder efficiency and could create additional costs. The enhanced information sharing obligations between manufacturers and distributors should be sufficient as a proper foundation for the regular reviews, especially considering the requirement for the distributor to provide, where appropriate, the manufacturer with information on the regular reviews.

Para. 3 of the draft Technical Advice should be amended to create a better alignment with MiFID II. The amended p. 3 should read:

> When reviewing existing products, the manufacturer shall consider if the product remains consistent with the needs, characteristics and objectives of the target market and consider if the product is being distributed to the target market, or is reaching customers ~~***outside of the target market***~~ ***for whose needs, characteristics and objectives the products is not compatible***."

We would suggest to remove the wording "on a continuous basis" from para. 4 of the draft Technical Advice, as paras. 1 and 2 already require manufacturers to perform regular reviews. This should imply

that the regular review should include an obligation to revisit the already pre-defined crucial events that could affect the risk for the customers. Furthermore, the wording "on a continuous basis" could lead to confusion as to how the requirement in para. 4 relates to the wording "regular" in paras. 1 and 2.

Furthermore, EIOPA could also consider to include examples of actions similar to MiFID II's draft Implementing Directive Article 9(15) to provide further clarity and create more alignment with MiFID II.

Para. 5 of the draft Technical Advice should be adapted to require the compliance function to "function to monitor the development and review of the product governance arrangements" rather than to oversee" the development and review of the product governance arrangements. In the light of the increased focus on the role of the compliance function, and its responsibilities, it is important to avoid using terminology that could indicate a first line responsibility being put on the compliance function.

With regards to the requirement to "review obligations for insurance distributors which advise on or propose insurance products which they do not manufacture", our comments are the same as to the preceding section.

9. Are there any other elements which you would consider appropriate in order to specify the regulatory requirements on conflicts of interest as laid down on Article 27 and Article 28, IDD? If possible, please specify in detail.

Para. 4(c) of the draft Technical Advice could be better aligned with the relevant provision in the MiFID II Level-2 rules which only refers to removing direct links between the remuneration of relevant persons principally engaged in one activity and the remuneration of different relevant persons principally engaged in another activity. Including "payments" in the requirement could be interpreted to include inducements, which in fact are allowed provided that any conflicts of interests are properly managed:

> "the removal of any direct link between ~~***payments, including***~~ remuneration, to relevant persons principally engaged in one activity and ~~***payments, including***~~ remuneration to different relevant persons principally engaged in another activity, where a conflict of interest may arise in relation to those activities"

EIOPA slightly redrafted the equivalent requirements of the MiFID II Level-2 in paras. 7, 8 and 9 of the draft Technical Advice, even though the requirements are exactly the same. In line with the Commission's mandate to achieve as much consistency as possible between IDD and MiFID II, and to make comparison of the requirements easier for market participants, we would suggest that the same language is used.

10. Do you agree that the policy proposals do not need further specification of the principle of proportionality and allow sufficient flexibility to market participants to adapt the organisational arrangements to existing business models? If you do not agree, please explain how the principle of proportionality could be elaborated further from your point of view?

We agree that there is no need for further specification of the principle of proportionality and to allow sufficient flexibility to market participants.

11. Do you agree with the proposed high level principle to determine whether an inducement has a detrimental impact on the relevant service to the customer?
12. Are there any further inducements which entail the high risk of leading to a detrimental impact and should be added to the list in paragraph 4 of the draft Technical Advice above?

Para. 4(a) of the draft Technical Advice should be further explained, as just referring to the situation where "a different product or service exists which would better meet the customer's needs" creates significant legal uncertainty for the distributor. We are certain that it is not EIOPA's intention to require detailed consideration of individual products across all types or classes of products for each individual customer. Such an approach would not be possible for firms to practically and effectively comply with and would therefore amount to a disproportionate requirement. Rather, the requirement should focus on whether products from within the firm's own product range would better meet the customer's needs. It is requested that EIOPA clarifies this in the Technical Advice.

Para. 4(b) of the draft Technical Advice explains that inducements should not predominantly be based on quantitative commercial criteria and that they should include qualitative criteria reflecting compliance with applicable regulations, fair treatment of customers and the quality of the services to customers. Can we assume that this wording was inserted to create a linkage between IDD and relevant MiFID II provisions? This could mean that the MiFID II quality enhancements criteria may be used by firms to demonstrate such qualitative criteria, as required by IDD, in order to prevent that inducements lead to a detrimental impact for customers investing in insurance-based investment products. EIOPA is requested to further clarify this point in the Technical Advice.

When trying to create alignment between IDD and MiFID II one element missing in the draft Technical Advice relates to MiFID II's requirement that ongoing inducement shall only be accepted as long as there is an ongoing service towards the client. As letter (c) of para. 4 deals with disproportionate or excessive inducements, we would argue that the following addition would create further clarity in this regard:

> *(c) the value of the inducement is disproportionate or excessive when considered against the value of the product and the services provided in relation to the product**, such as the insurance intermediary or insurance undertaking receiving an on-going inducement for the provision of a one-off advice***;

Furthermore, it is our expectation that payments or benefits which enable or are necessary for the provision of services, and which by their nature cannot give rise to conflicts of interests with the obligation to act in the best interests of the customers, would not be subject to the inducements requirements.

13. To which extent are inducements which are considered bearing a high risk of detrimental impact part of existing business and distribution models? Please specify your answer and describe the potential impact of these proposals (if possible with quantitative data).

No comment

14. Are there any further organisational measures or procedural arrangements which you would consider important to monitor whether and to ensure that inducements have no detrimental impact on the relevant service to the customer and do not prevent the professional from complying with their obligation to act honestly, fairly and in accordance with the best interests of their customers?

EIOPA did not include specific rules on the disclosure of inducements to clients, while this has been done in MiFID II. However, receipt of inducements in relation to a distribution service has been recognised by EIOPA as a potential source of conflicts of interest (cf. para. 2 (c)) on page 45 of the consultation paper). Therefore, it would make sense to disclose all costs and charges to the clients and the transparency requirements in the conflicts of interests section, that the firm has an obligation to specifically inform clients about inducements.

15. Do you agree with the high level criteria used to specify the assessment of suitability and appropriateness? Are there any criteria you would exclude, and why?

In order to better align the IDD requirements with the MiFID II requirements, EIOPA could follow the logical order used in MiFID II. Paras. 4 and 5 of the Technical Advice could therefore be moved to become paras. 1 and 2 of the Technical Advice.

Furthermore, para. 2 of the draft Technical Advice should be aligned further with the equivalent MiFID II text as the requirement under MiFID II and IDD are the same. The amended paragraph should read as follows:

> "Without prejudice to the fact that any contract of insurance proposed shall be consistent with the customer's insurance demands and needs under Article 20(1), IDD, an insurance intermediary or insurance undertaking shall obtain from customers or potential customers such information as is necessary for the insurance intermediary or the insurance undertaking to understand the essential facts about the customer and to have a reasonable basis for determining, ***giving due consideration to the nature and extent of the service provided,*** that the personal recommendation satisfies the following criteria:

(a) it meets the customer's investment objectives, including that person's risk tolerance;
(b) it ~~***meets the customer's financial situation***~~ ***is such that the customer is able financially to bear any related investment risks consistent with the customer's investment objectives***, including that person's ability to bear losses;
(c) it is such that the customer has the necessary knowledge and experience in the investment field relevant to the specific type of product or service***, in order to understand the risks involved in the transaction***."

Furthermore, para. 9 of the draft Technical Advice is missing a MiFID II requirement [Draft Delegated Regulation, Article 54(7), para 2] to maintain adequate and up-to-date information when having an on-going relationship with a customer. Such a requirement should also be included in EIOPA's Technical Advice.

Lastly, para. 13 of the draft Technical Advice should be further aligned with the equivalent MiFID II requirement [Draft Delegated Regulation, Article 55(1)] as the IDD/MiFID II texts are the same. The amended paragraph should read:

"The necessary information regarding the customer's or potential customer's knowledge and experience in the investment field, includes, where relevant, the following to the extent appropriate to *the* ***nature of the customer and*** the ***nature and extent of the*** specific type of product or service***, including the complexity and risks involved***:"

Even though IDD does not set out different customer categories, it is still relevant to consider the nature of the customer as it will be a part of the target market considerations.

16. When EIOPA is reflecting insurance specificities in the policy proposals above, do you agree with them? In particular, with regard to insurance specificities related to the protection elements within an insurance-based investment product (e.g. biometric risk cover), are there aspects regarding the information to obtain (such as the 'risk profile') for the assessment of suitability and appropriateness that would necessitate further and/or more explicit insurance specificities?

No comment

17. In practice, what information do you expect to collect for the assessment of suitability and appropriateness in addition to the demands and needs?

We would expect suitability and appropriateness assessments by the distributor of insurance-based investment products to be aligned with the requirements in MiFID II. Information to be collected should thus contain the following:

- Personal situation, including family situation, education and profession
- Investment objectives and purpose, including time horizon

- Financial situation, including regular income, assets, liabilities and commitments
- Customer perception about risks and risk willingness as well as the customer's views on returns and return expectations
- Customer knowledge and experience with the relevant products in scope of the service

18. Do you think that it could be useful for EIOPA to provide any specification and/or guidance on the relationship between the demands and needs test and the suitability/appropriateness assessment, in a separate policy instrument, given that this point is not addressed in this Technical Advice?

We do not believe it necessary to further clarify the relationship between the demands and needs test and the suitability/appropriateness assessment. Since the suitability/appropriateness assessment is strictly applicable for the distribution of insurance-based investment products, and since it effectively includes an assessment of the demands and needs of the customer, fulfilling the requirements on assessing suitability/appropriateness should automatically fulfil the demands and needs test.

19. Do you agree with the high level and cumulative list of criteria used to define other non-complex products? Are there any you would make optional or exclude, and why?

We think that the relation between the scope of non-complex products under MiFID II and the non-complexity test provided in the draft Technical Advice should be made clearer: According to Article 30(3)(a)(i) of IDD, insurance contracts which only provide investment exposure to financial instruments deemed non-complex under MiFID II and do not incorporate a structure which makes it difficult to understand the risk involved shall be deemed non-complex without further testing. This privileged treatment applies not only to financial instruments which are explicitly classified as non-complex in Article 25(4)(a) of MiFID II, but also to instruments which pass the non-complexity test provided for in Article 57 of Delegated Regulation to MiFID II. **Consequently, any insurance product which offers investment exposure to any non-complex financial instrument shall itself be deemed non-complex provided that it complies with the second criterion foreseen in Article 30(3)(a)(i) of IDD.**

This understanding of the underlying Level-1 provision is insufficiently reflected in the draft Technical Advice which speaks only about "investments embedded that are not explicitly specified in Article 25(4)(a) [as being non-complex]". This wording seems not to include underlying investments which pass the complexity text according to MiFID II Level-2 and therefore, does not adequately take into account the relevant IDD provision. In our view, para. 1 should be supplemented as follows:

> *An insurance-based investment products with investments embedded that are not explicitly specified in Article 25(4)(a) of Directive 2014/65/EU* ***or do not fulfil the requirements of Article 57 of Delegated Regulation [No. to be inserted]*** *shall be considered as non-complex […]*

20. Are there any further high level criteria which you would consider necessary and important, and why? In particular, how could insurance specificities be taken into account?

No comment

21. While point (i) of point (a) of paragraph 3 of Article 30 is intended to capture the majority of non-complex products, the above listed criteria should capture equally non-complex products falling outside of point (i). Are there any gaps?

Please see the first part of our response to Question 19.

22. On retention of records, do you agree with the high level criteria used? Are there any you would exclude, and why?

We question EIOPA's analysis and conclusion to not include an equivalent to the MiFID II requirement to enter into a basic written agreement with the customer. The MiFID II requirement is based on Article 25(5) which is identical to IDD's Article 30(4). The Commission's request is also very similar. During its Level-2 work on MiFID II ESMA eventually concluded that the requirement to enter into a basic written agreement was consistent with the Commission's mandate. This was included in the draft Delegated Regulation Article 58. Based on the fact that written agreements strengthen legal certainty and enable clients to better understand the nature of the service provided, EIOPA should also include a requirement to enter into a basic written agreement.

Lastly, after reading para. 16 we would consider para.17 of the draft Technical Advice redundant and should thus be removed. The specific cases referred to in subparas. (a) and (b) are an integral part of the suitability assessment and are already covered by the obligation of para.16 to maintain adequate recording and retention arrangements regarding the suitability assessment.

23. When EIOPA is reflecting insurance specificities in the policy proposals, do you agree with them?

No comment

24. Do you agree with the high level criteria used with regard to the suitability statement and the periodic communications to customers? Are there any criteria you would exclude, and why?

No comment

25. When EIOPA is reflecting insurance specificities in the policy proposals, do you agree with them?

No comment

26. Should EIOPA specify further criteria with regard to the periodic communication to customers, such as the division of responsibility or more details on the online system?

No comment

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