

## CP17/23 Insurance Distribution Directive Implementation – Consultation Paper 2

### Introduction

This CP follows on from [CP17/7](#) (See Gem Briefing Note [17/1](#)) further explaining how the FCA proposes to implement the Insurance Distribution Directive (IDD) in the UK, effective from 23/02/18.

The IDD extends the application of the EU's insurance regulatory requirements to all distributors of insurance products, with the objective of enhancing undistorted competition, consumer protection and market integration. This CP covers implementation of most outstanding Level 1 matters and the IPID (Insurance Product Information Document) disclosure requirements.

The FCA will be consulting separately, in the next few months, on its remaining proposals for implementing the IDD. This will include proposals to reflect the Level 2 delegated acts in the FCA's Handbook. It will also address any Handbook changes arising from the Treasury's consultation on implementing the IDD, including any changes to regulatory processes and the Perimeter Guidance Manual (PERG). In addition the third CP will consider the Commission's draft delegated regulations.

The proposals put forward in this CP are said to complement other FCA and European work in the asset management sector including MiFID (Markets in Financial Instruments Directive) II and PRIIPs (Packaged Retail and Insurance based Investment Products Regulation).

The FCA's implementation of the IDD goes beyond the minimum requirements by proposing to:

- apply the IDD standards to a wider range of firms than required by the Directive, to promote effective competition in the interests of consumers by achieving consistency of regulatory standards and avoiding arbitrage,
- maintain standards above the IDD minimum requirements to preserve existing UK regulatory standards, and
- introduce standards above the IDD minimum requirements as a result of policy decisions, particularly in relation to alignment with MiFID II.

A directly applicable Commission Implementing Regulation will support the IPID. At the beginning of August, EIOPA published a CP ([EIPOA-CP-16/07](#)) on proposed implementing technical standards for the IPID. However, the FCA's proposals have been based on the previously drafted Implementing Technical Standards for the IPID published by EIOPA and are therefore subject to change.

## High-level Overview

### Structure of the CP

The CP is split into two parts:

- Part I - Proposals to implement the IDD requirements for life insurance business, including information provision requirements, and additional requirements related to the distribution of insurance-based investment products (IBIPs):
  - a. firms' general conduct of business obligations from Chapter V of the IDD (Chapter 4),
  - b. information disclosure to customers (Chapter 5),
  - c. inducements (Chapter 6),
  - d. suitability (Chapter 7), and
  - e. appropriateness (Chapter 8).
- Part II - Changes to rules to implement requirements in the IDD that apply to both life and non-investment insurance business:
  - f. conflicts of interest (Chapter 9),
  - g. product oversight and governance (Chapter 10),
  - h. organisational requirements relating to the protection of customers' money (Chapter 11), and
  - i. professional requirements relating to the good repute of employees of insurance distributors (Chapter 12).
- Changes relating to non-investment insurance business *only*, including product information, are covered in Chapter 13 and consequential Handbook amendments are covered in Chapter 14.

### Part I Proposals

#### **a. Firms' general conduct of business obligations from Chapter V of the IDD (Chapter 4 , pages 13-14)**

In CP17/7 the FCA set out its proposals for implementing the Chapter V requirements for insurance business covered by the Insurance: Conduct of Business sourcebook (ICOBS). The FCA proposes to implement broadly similar rules in COBS.

The CP contains a summary of these proposals, which is outlined below, but the FCA states these proposals should be read alongside those in Chapters 5 and 6 of CP17/7.

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- IDD General Principles:
  - ➔ extension of client's best interests and clear, fair and not misleading rules to all clients along with the rule that marketing material should be clearly identifiable as such.
  - ➔ The proposed rule from CP17/7 linked to the IDD prohibition on remuneration/incentives that could conflict with the client's best interests (in SYSC 19F) is to be extended to all life policies.
- Disclosure of the 'nature and basis' of remuneration by intermediaries and by insurers of the 'nature' of remuneration paid to their employees.
- Sales standards - new rules in COBS 7.3 (for non-advised sales), COBS 9A (for advised sale of IBIPs) and COBS 9 (for advised sale of other life policies) to cover the enhanced IDD requirements on demands and needs for both advised and non-advised sales:
  - ➔ Firms must identify and specify the customer's demands and needs on the basis of information obtained from the customer. Additionally, all insurance contracts proposed, including those sold on a non-advised basis, must be consistent with the customer's insurance demands and needs,
  - ➔ Where advice is provided, the firm must provide a personalised recommendation explaining why a particular product best meets the customer's needs, and
  - ➔ Where advice is given on the basis of a fair and personal analysis of the market, the firm must base this on a sufficiently large number of products to enable it to make a personal recommendation (COBS 6.1ZA).
- Cross-selling - the FCA proposes the introduction of rules in COBS 6.1ZA similar to those which were proposed in CP17/7 for ICOBS 6A.3:
  - ➔ Where insurance is a primary product sold with a non-insurance ancillary product, the firm must inform the customer whether the ancillary product is optional. If it is, they must give an adequate description of the products (including costs), and
  - ➔ Where insurance is sold ancillary to a non-insurance primary product, it must be optional.
- Distribution – implementation of new rules in COBS 7.3 for firms using exempt ancillary insurance intermediaries to distribute their products.
- Other changes proposed by the FCA:
  - ➔ introduction of new rules in COBS that specify the way in which information required by the IDD is to be provided – e.g. on paper, and free of charge where requested by client,
  - ➔ relocation and amendment of the rules currently in COBS 7.2.1R to COBS 6.1ZA covering general pre-contract disclosures concerning the firm's identity, scope of service, complaints process and include new rules to cover the obligations on insurers that distribute products directly to customers, and

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- ➔ relocation to COBS 6.1ZA and amendment of the disclosures required of intermediaries concerning transparency and links between the firm and insurers with which they place business (which are currently in COBS 7.2.1R (1) to (2)).

## **b. Information disclosure to customers (Chapter 5)**

The IDD introduces a range of new requirements for firms distributing IBIPs including providing appropriate information, providing adequate periodic reports to customers and keeping a record of customer agreements:

- Article 29(1) - appropriate information to be provided to the customer including, at least, all costs and charges, risk warnings and whether the firm will conduct periodic assessments of suitability. This information may be provided in a standardised format to customers, and the obligation applies in addition to the general requirements of the IDD, which are covered in Chapter 4 of this paper.
- Article 30(4) - firms to establish and keep a record of a document that includes the rights and obligations agreed with customers and any other relevant terms of service. These are usually referred to as client agreements.
- Article 30(5) - adequate reports on the firm's service are provided to customers in a durable medium. These periodic reports must include, where applicable, the costs associated with the transactions and services undertaken on behalf of the customer.

These disclosure requirements will apply in relation to all customers purchasing or receiving advice on an IBIP, including professional clients and eligible counterparties (ECPs), although no prescribed format for disclosures is proposed at this time.

The FCA proposes amendments to:

- COBS 2.2 and COBS 2.2A - These changes will implement most of the appropriate information requirements of IDD Article 29(1) into COBS 2.2A. In addition, the existing requirements for life policies are relocated into the new COBS 2.2A to consolidate rules while retaining existing standards.
- COBS 6.1ZA - These changes implement the costs and charges disclosure for IBIPs of IDD Article 29(1)(c).
- COBS 8 and COBS 8A - These changes implement the requirement of IDD Article 30(4) to establish and keep a record of documents agreed between the firm and customer setting out rights and obligations.
- COBS 16A - These changes implement the requirement of IDD Article 30(5) for firms distributing IBIPs to provide adequate reports on the service provided in a durable medium to customers.

## **c. Inducements (Chapter 6)**

The IDD requires that the payment of inducements by a third party must not have a detrimental

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impact on the quality of the service. This differs from the MiFID II requirement that inducements must be designed to enhance the quality of the service. The FCA considers that there are circumstances in which the MiFID II test may deliver better consumer outcomes. Therefore, the FCA intends to retain this and to include the additional IDD wording in its rules.

In some areas, the MiFID II delegated acts include additional detail compared to the IDD with regard to inducements. The FCA is considering levelling up to MiFID II requirements in these areas.

Specifically the FCA's proposals include:

- applying the high level inducement rule in COBS 2.3A to firms doing insurance distribution activities in relation to IBIPS, and within that section including the new requirements as necessary to implement the Article 29(2) requirement (and for this business COBS 2.3 won't apply),
- maintaining the existing requirements in COBS 2.3 for other life policies without changes, and
- continuing to apply the RDR rules in COBS 6: COBS 6.1, 6.1A-G, and 6.4. Also see COBS 6.1ZA.2 of the draft Handbook text.

#### **d. Suitability (Chapter 7)**

The IDD requirements are similar to those contained in MiFID II and the FCA's current COBS requirements.

Under the IDD, when providing a personal recommendation, firms are required to:

- assess whether the product recommended is suitable for that person, particularly in relation to their risk tolerance and ability to bear losses,
- collect information about the customer including their investment knowledge and experience, financial situation, ability to bear losses, investment objectives and risk tolerance,
- assess the suitability of the overall package where advice is provided on a package of bundled services or products,
- provide a suitability statement, in a durable medium, to the customer to specify the advice provided and how that advice meets the preferences, objectives and other characteristics of the customer, and
- update the suitability statement where the customer has been informed that a periodic assessment of suitability will occur.

To incorporate these requirements the FCA proposes to:

- integrate the IDD requirements for suitability into the new COBS 9A for IBIPs. Current suitability requirements in COBS 9 will continue to apply to other life policies,

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- implement the demands and needs requirements for advised sales under Article 20 of the IDD alongside the suitability test in COBS 9A for IBIPs and in COBS 9 for other life policies,
- apply the demands and needs requirements of IDD to insurance undertakings as well as insurance intermediaries,
- change the basic advice rules of COBS 9 to implement the IDD minimum requirements,
- relocate the current minimum five-year record retention period requirements of COBS 9 to SYSC 9 for intermediaries and SYSC 3 for insurers,
- not require firms advising professional clients in relation to an IBIP to provide a suitability statement but a demands and needs statement will still be required,
- require insurance intermediaries and insurance undertakings to assess suitability for professional clients but they will have greater flexibility about how to communicate the outcome of the assessment to professional clients, and
- require firms to tell all customers whether or not a periodic assessment will be conducted.

MiFID II provisions allow firms to assume the knowledge and experience of professional clients for the suitability test. This matter was not included in the EIOPA technical advice for the IDD, so it is possible this will not be addressed in the IDD delegated acts. In the absence of any specific provisions in the IDD, the ability to assume professional client knowledge and experience for the purposes of the suitability test would not apply to IBIPs. However, where possible under the final delegated acts, the FCA's current intention is to align the IDD obligations for professional clients to MiFID II.

## **e. Appropriateness (Chapter 8)**

The IDD requires the following:

- For non-advised sales, the customer's investment knowledge and experience should be assessed to determine whether the IBIP provided is appropriate for them - the appropriateness test, under which the firm must gather information about the customer's knowledge and experience of the investment considered.
- Where an IBIP is not considered to be appropriate, or where there is not sufficient information available about the customer's knowledge and experience to make the assessment, a warning must be provided to the customer.
- For packaged sales, the overall package should be assessed as appropriate for the customer.
- The IDD permits the sale of IBIPs without an appropriateness test where certain conditions for an execution-only sale are met:
  - ➔ the IBIP meets the specific criteria for non-complex products,
  - ➔ the firm complies with the conflicts of interest requirements of the IDD (and the IDD overall),

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- ➔ the sale is carried out at the initiative of the customer, and
- ➔ there is a warning to the customer that appropriateness has not been assessed.

The FCA proposes to:

- integrate the IDD appropriateness requirements into the new COBS 10A and to apply these to IBIPs only,
- integrate the associated record-keeping requirements, including a minimum retention period of five years into SYSC 9 for intermediaries and SYSC 3 for insurers in line with its approach to suitability and MiFID II,
- exercise the derogation to allow non-complex IBIPs to be sold under the execution-only process,
- integrate the IDD execution-only requirements into the new COBS 10A - a range of other IDD requirements will still apply to execution-only sales, including enhanced requirements around demands and needs and the customer's best interest duty, and
- integrate the IDD requirements on product complexity into the new COBS 10A.4.

## Part II Proposals

### f. Conflicts of interest (Chapter 9)

Amongst other things the IDD requires firms to:

- take all appropriate steps to identify conflicts of interest between themselves and their customers, or between one customer and another,
- take all reasonable steps to prevent conflicts of interest, and
- where the arrangements put in place to manage conflicts of interest are not sufficient to ensure that the risks of damage to customer interest will be prevented, disclose to the customer the general nature/sources of any conflicts.

The FCA proposes to:

- maintain the current approach of applying conflict of interest requirements to distributors of all types of insurance (including all life and general insurance business) rather than limiting the application to IBIP business only,
- level up to MiFID II requirements where MiFID II goes beyond the IDD Level 1 requirements (for example, in relation to the disclosure of conflicts),
- apply relevant existing rules (as amended following MiFID II implementation) to firms carrying on insurance distribution, and

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- copy out IDD requirements that go beyond those in MiFID II.

## **g. Product oversight and governance (Chapter 10)**

The IDD Level 1 provisions require firms that manufacture insurance products to:

- maintain, operate and review a product approval process for new products, and existing products to which significant adaptations have been made, before such products are marketed or distributed,
- specify a target market for each product,
- ensure all relevant risks to the target market are assessed,
- develop a distribution strategy consistent with the target market,
- take reasonable steps to ensure the product is distributed to the target market,
- regularly review products, to ensure at the very least the product remains consistent with the needs of the target market and the distribution strategy remains appropriate, and
- make available all appropriate information on products and the product approval process to distributors.

Firms that distribute products that they do not manufacture are required to have in place adequate arrangements to obtain information about the product and the product approval process, and to understand the identified target market.

The FCA considers the guidance on firms' obligations in the Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD) covers broadly similar matters as the IDD provisions. Therefore, the FCA does not expect the introduction of the new provisions to require significant change for UK firms in practice.

To implement MiFID II product governance requirements the FCA is introducing a new sourcebook, the Product Intervention and Product Governance sourcebook (PROD). In general, the IDD and MiFID II product governance requirements are similar, though not fully aligned with MiFID II going further than the IDD in a number of areas. Therefore, the FCA proposes to:

- introduce a new Chapter to the PROD sourcebook to implement the provisions for insurance business and these new rules will replace broadly equivalent existing RPPD guidance for firms within scope of PROD,
- use the MiFID II definitions for 'manufacturer' and 'distributor' with necessary adaptations to give effect to the IDD scope and to help explain the concepts of manufacturing and distributing, and
- apply the product governance requirements to all firms involved in insurance product manufacture and distribution.

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Many of the detailed IDD provisions for product governance appear in the IDD delegated acts, which will be dealt with in the third CP.

## **h. Organisational requirements relating to the protection of customers' money (Chapter 11)**

The IDD requires that, in order to protect customers against the inability of insurance and reinsurance intermediaries to i) transfer premiums to the insurance undertaking, ii) transfer claim monies, or iii) return premiums to the insured, one or more of the following options should be implemented:

- risk transfer, whereby premiums paid by the customer to the intermediary are treated as having been paid to the insurance undertaking, and monies paid by the insurance undertaking are not treated as having been paid to the customer until they receive them,
- customers' monies are kept in strictly segregated customer accounts, and
- intermediaries have financial capacity of 4% of annual premiums received, and/or
- a guarantee fund is set up.

There are no delegated acts with respect to protection of customers' money.

To implement the requirements, the FCA proposes to:

- retain the existing capital regime for insurance intermediaries (based on 5% of commission rather than 4% of annual premiums) or require a guarantee fund to be set up,
- apply the IDD requirements on protection of customers' money through the existing options of segregation and risk transfer contained in CASS 5, and
- make CASS 5 mandatory for reinsurance mediation.

## **i. Professional requirements relating to the good repute of employees of insurance distributors (Chapter 12)**

The IDD requires that natural persons working in an insurance or reinsurance undertaking/intermediary, who pursue insurance or reinsurance distribution shall be of good repute. Firms should therefore establish, maintain and keep appropriate records to demonstrate compliance with this requirement.

To reflect the Directive's requirements the FCA proposes to:

- modify the existing good repute rules to implement the IDD good repute requirements,
- move the rules from MIPRU to SYSC so the relevant professional requirements are all in the same sourcebook,
- maintain the application of the provisions, applying them to all firms with a Part 4A permission to carry on insurance mediation activity, other than connected travel providers,

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- introduce a good repute requirement for in scope AIs (Ancillary Insurance Intermediaries - see [Gem Briefing Note 17/1](#) and [CP17/7](#)) in relation to natural persons responsible for ancillary insurance distribution, and
- transpose the relevant IDD record-keeping requirements into SYSC 23 and apply the requirement to all firms to which the good repute requirements apply.

## Other Proposals

### Changes relating to non-investment insurance business only, including product information (Chapter 13)

The majority of the changes to ICOBS were consulted on in CP17/7, however Chapter 13 of this CP looks at:

- product information disclosure requirements,
- the Insurance Product Information Document (IPID) – a short summary of a policy, similar to the current policy summary document set out in ICOBS 6 Annex 2, which presents relevant information about the insurance policy in a standardised format – and
- the use of third-party processors.

The IDD requires:

- customers to be provided with objective and relevant information about the product, prior to conclusion of the insurance contract in a comprehensible form in order to allow the customer buying insurance to make an informed decision.
- the product manufacturer to draw up the IPID and focus on the key information a consumer needs to make an informed decision about the product, and
- An IPID to be produced for each new insurance policy, including renewals and those policies distributed as part of a package sale.

The FCA therefore proposes to:

- retain the current appropriate information rule in ICOBS 6.1.5R with some additions and clarifications to implement the IDD product information requirements, and continue to apply it to the sale of non-investment insurance contracts to all customer types,
- Relocate the Producing and Providing Product Information section to ICOBS 6.1A that contains the responsibilities of insurers and intermediaries, and add the new obligation that the IPID must be drawn up by the product manufacturer,
- Introduce the new requirement in ICOBS 4.1A that product information must be provided in a durable medium,

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- introduce Handbook guidance that firms need to consider their product governance arrangements when producing and providing product information,
- introduce Handbook guidance that firms need to consider the merits of providing a short summary of the policy including information set out in the IPID information requirements, even where not required by the IDD, for commercial customers,
- introduce a new rule requiring an IPID to be provided to consumers in relation to general insurance contracts (that is, not including pure protection contracts) as set out in the new ICOBS 6.1.10A,
- retain the current requirement to provide a policy summary document in relation to pure protection contracts - this will maintain current requirements for pure protection contracts that fall outside the new IPID requirements,
- introduce a rule to retain the current requirement that, in relation to payment protection contracts, a firm must provide information about its complaints processes and access to compensation schemes such as the Financial Services Compensation Scheme (FSCS),
- exclude contracts in relation to 'large risks' from the IPID requirements as enabled by Article 22(1) of the IDD,
- copy-out the IPID requirements of IDD Article 20(7) and (8) which specify the content of the IPID,
- reproduce the Implementing Regulation for the IPID in the Handbook and apply format and template requirements as rules to firms to which the Regulation is not directly applicable, and
- introduce new Handbook guidance clarifying that other pre-contractual disclosures may be required in addition to the IPID such as the Demands and Needs statement and its existing requirements related to Guaranteed Asset Protection (GAP) products,
- retain the current appropriate information rules for commercial customers and not extend the IPID template beyond consumers. However, IDD transposition work with the Commission is ongoing and the IDD is not clear about which customers must receive an IPID,
- introduce additional Handbook guidance emphasising that information provided to commercial customers should be relevant and comprehensible, and
- apply the disclosure regime required of the insurer to third-party processors acting for an insurer.

This Chapter of the CP also contains an FAQ table based on early stakeholder discussions regarding the IPID.

## **Consequential Handbook amendments (Chapter 14)**

These proposed changes are largely administrative, do not reflect any change in policy and generally consist of the addition of cross-references to IDD requirements.

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## Next Steps

Comments on this CP are requested by 20/10/17 and the FCA is aiming to publish a policy statement in December 2017.

The full CP can be accessed [here](#).

*This note is intended as a summary only. It is not full and/or firm specific advice and it is the responsibility of each regulated firm to ensure they fully consider relevant FCA publications.*

*For further information, please contact Gem Compliance Consulting Ltd.*