

CP17/33 - Insurance Distribution Directive Implementation – Consultation Paper 3

Introduction

The IDD entered into force on 23 February 2016 and firms must follow its requirements from 23 February 2018.

Like the Insurance Mediation Directive (IMD), the IDD covers the authorisation, passporting arrangements and regulatory requirements for insurance and reinsurance intermediaries. However, the application of the IDD is wider, covering organisational and conduct of business requirements for insurance and reinsurance undertakings. The IDD also introduces requirements in new areas – e.g. product and oversight governance (POG).

The IDD empowers the Commission to adopt delegated acts related to the POG requirements and in relation to the distribution of IBIPs (insurance-based investment products). The Commission published two draft IDD regulations for consultation on 20 July 2017:

- the delegated act on POG requirements for insurance undertakings and insurance distributors (referred to as the [draft POG Regulation](#)); and
- the delegated act on conduct of business rules for the distribution of IBIPs (referred to as the [draft IDD Regulation](#)).

CP17/33 CP has been prepared using the draft POG and IDD Regulations, which were adopted by the Commission on 21 September 2017. Therefore the FCA will consider whether any additional changes are necessary as a result of the final versions in due course.

Some Handbook changes are contingent on changes to be made to legislation. The proposals are currently based on HMT's draft statutory instrument, which is subject to change, so the FCA may need to consult again when the statutory instrument is finalised.

Due to the links between the IDD provisions and the draft regulations, and the way in which firms utilise COBS, the FCA plans to reproduce the provisions of the POG and IDD Regulations in its Handbook, so that firms will have a single point of reference for seeking to understand the IDD requirements.

In this CP the FCA is consulting on its final proposals for implementing the IDD. The proposals cover the delegated acts, alignment with MiFID II and those relating to changes to UK legislation:

Part I – for life insurance distribution business, in relation to:

- inducements requirements for IBIPs (Chapter 4)
- suitability and appropriateness requirements for IBIPs (Chapter 5)

November 2017

- disclosure requirements for IBIPs and mandatory occupational pensions (Chapter 6)

Part II – for all insurance distribution business, including life and non-investment business, in relation to:

- conflicts of interest (Chapter 7)
- product oversight and governance (Chapter 8)
- changes to the Perimeter Guidance (Chapter 9)
- regulatory processes (Chapter 10)
- additional changes, including consequential amendments, to other parts of the Handbook (Chapter 11)

In some places the FCA's proposals go beyond the minimum standards required by the IDD, and these areas are explained in more detail in Chapter 3 and in Annex 2 of CP17/33.

Stakeholders are advised to read this CP together with CP 17/23. For ease of consultation, the draft Handbook text included in Appendix 1 of CP17/33 is prepared as if the amendments proposed in CP 17/23 have been made and so are not identified by underlining/strike through.

High-level Overview

Chapter 3

The FCA proposes to go beyond minimum standards by:

- Applying the IDD standards to a wider range of firms or businesses than required by the directive and delegated acts, so that consistency of regulatory standards is achieved – e.g. application of product governance requirements, and related IDD and POG regulations, to all firms involved in insurance product manufacture and distribution.
- Maintain standards above the IDD minimum requirements to preserve existing UK regulatory standards – e.g. rules for adviser charging for retail investment products.
- Introduce standards above the IDD minimum requirements, particularly in relation to alignment with MiFID II, again to achieve consistency of regulatory standards.
 - ➔ IBIPs and pensions within the scope of the IDD are generally viewed as being in the same relevant market as MiFID II investment products. IBIPs and pension products are also within the scope of the FCA's definition of a 'retail investment product' (RIP) and are therefore, subject to the rules put in place by the Retail Distribution Review (RDR). Therefore, the FCA proposes to incorporate the IDD requirements in COBS alongside equivalent MiFID II requirements.
 - ➔ Pensions: those that take the legal form of an insurance contract are not IBIPs but they will

November 2017

be subject to certain IDD requirements. Therefore, firms selling them need to consider the following areas of the IDD:

- disclosures about mandatory insurance-based occupational pensions (Chapter 6);
- product oversight and governance (Chapter 8); and
- regulatory processes (Chapter 9).

The FCA is also proposing to go beyond the minimum IDD requirements for firms involved in the provision of pensions that take the legal form of an insurance contract:

- maintenance of existing inducements standards (see Chapter 4);
- application of the same requirements for managing of conflicts of interest (see Chapter 7) for all types of insurance business; and
- improvement of alignment with the MiFID II product oversight and governance rules by introducing some requirements based on MiFID II provisions (see Chapter 8).

Part I for life insurance distribution business

1. Inducements requirements for IBIPs (Chapter 4):

There are some differences between the approach proposed in the IDD (including in the IDD Regulation) and the approach set out in MiFID II. MiFID II requires that the inducement is designed to enhance the quality of the relevant service to the client, while the IDD requires that the inducement does not have a detrimental impact on the quality of the relevant service.

Where the IDD differs from MiFID II, the FCA intends to copy out the IDD requirements in addition to the COBS 2.3A requirements for MiFID II.

The IDD Regulation sets out non-exhaustive criteria for insurance intermediaries and undertakings to assess whether inducements (and inducement schemes) have a detrimental impact, having regard to all relevant factors, which may increase or decrease this risk and any organisational measures taken to prevent it.

In addition to the proposals set out in CP17/23, the FCA proposes in CP17/33 to:

- Reproduce within COBS 2.3A of the relevant provisions on inducements of the IDD Regulation, and apply the requirements as rules for firms, which are subject to existing rules but not within scope of the IDD.
- Apply the MiFID II additional requirements relating to sales involving more than one distributor firm, record keeping and ongoing assessments firms must make to ensure that inducements enhance the quality of services, to IBIPs.
- Not to apply COBS 2.3A record keeping obligations to IBIPs – the SYSC 3 and 9 requirements

November 2017

will continue to apply.

- Include the detrimental impact test in COBS 6.1A for IBIPs.

2. Suitability and appropriateness requirements for IBIPs (Chapter 5):

The IDD requires firms to assess either the suitability or appropriateness of an IBIP for the customer depending on whether advice (a personal recommendation) is provided. For advised sales, the firm must assess whether the IBIP is suitable for the client. For non-advised sales, the customer's investment knowledge and experience should be assessed to determine whether the IBIP provided is appropriate for them. Other requirements are also contained in the IDD Regulation.

The FCA proposes to:

- Reproduce the IDD Regulation in the Handbook alongside the relevant suitability provisions in COBS 9A, appropriateness provisions in COBS 10A and record-keeping provisions in SYSC 3 (for insurers) and SYSC 10 (for intermediaries).
- Apply these IDD Regulation requirements as rules for firms, which are subject to the FCA's existing rules but to which the IDD Regulation does not apply directly.
- Translate some words and phrases used when applying the IDD regulation as rules into Glossary terms as part of a new COBS 1.3.
- Provide guidance on SYSC 9.2 (which is consulted on in CP 17/23) to clarify the interaction of this rule with the retention period specified in the IDD Regulation.
- Update its guidance on assessing suitability at COBS 9A.2.21G to include IBIPs. This is to clarify that the suitability test includes consideration of the type, characteristics and frequency of transactions.
- Amend COBS 2.4 (and guidance in COBS which cross refers to that chapter) to include a rule in relation to IBIPs, which will enable a firm to rely on a suitability test or an appropriateness test conducted by another firm.

3. Disclosure requirements for IBIPs & mandatory occupational pensions (Chapter 6):

This chapter sets out our proposals to implement the IDD requirement relating to providing information to members of mandatory occupational pension schemes and to include additional disclosure requirements for life insurance policies (including IBIPs) based on existing requirements in COBS 6.1.

The FCA's proposals include the following:

- Maintain current requirements by introducing new rules for insurance distribution in COBS 6.1ZA, which reflect the current requirements of COBS 6.1.

November 2017

- Introduce guidance in COBS 1.3, based on the MiFID II guidance in COBS 1.2, to explain the meaning of 'in good time' for life insurance distribution business. The guidance encourages firms to consider the amount of time a customer will need to read and understand information, taking into account the urgency of the situation and the relative complexity of the product or service in question.
- Article 22(5) of the IDD sets out information disclosure requirements for an insurance distributor when an employee becomes a member of a mandatory occupational pension arrangement, without having taken an individual decision to join it. In these cases, the information requirements contained in Chapter V of the IDD must be met.

The IDD does not define what would qualify as a 'mandatory occupational pension arrangement'. Therefore, legislative requirements to auto-enrol employees into a pension might mean that some UK schemes qualify. The FCA is proposing to implement the Article 22(5) requirement in order to ensure that its rules operate appropriately for any arrangements that may qualify.

The way pensions arrangements are structured in the UK means insurance distributors may not have contact details for each employee that becomes a member, so distributors may not be able to ensure employees receive the required information. Therefore the FCA is proposing the introduction of a new rule in COBS 19, which will require insurance distributors responsible for the provision of these occupational pension arrangements, when carrying on insurance distribution, to make the relevant information available to pension operators/scheme trustees in the expectation of prompt onward provision to individual members upon enrolment.

Part II for all insurance distribution business, including life and non-investment business

1. Conflicts of interest (Chapter 7):

This chapter sets out the FCA's proposals in relation to the conflicts of interest requirements of the Level 2 IDD Regulation.

The IDD includes provisions designed to prevent conflicts of interests leading to consumer harm in the distribution of IBIPs. At a high level, firms are required 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 from damaging customer interests; 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 or sources of any conflicts.

In CP 17/23 The FCA proposed to implement the IDD requirements in relation to conflicts of interest to all types of insurance, rather than just to IBIP business to maintain the scope of its rules and consumer protections. In CP17/33 the FCA considers further amendments to SYSC 3 in the

November 2017

light of the IDD Regulation to ensure consistency of approach.

The IDD Regulation provides for, amongst other things, the identification of conflicts of interest, the establishment and maintenance of a conflicts policy and the disclosure of conflicts. These provisions are closely aligned with those of MiFID II, but in some cases add insurance-specific requirements, which the FCA proposes to reflect in its rules as follows:

- Reproduce the relevant provisions of the IDD Regulation in SYSC 3 (for insurers) and in SYSC 10 (for other firms to whom the regulation applies directly).
- For firms to whom the IDD Regulation does not apply directly (i.e. out of scope firms conducting insurance distribution business) the FCA proposes to apply the requirements as rules in SYSC 3 (for insurers) and in SYSC 10 to rely on the rules in place (as amended for MiFID II) with necessary amendments for IDD. (See SYSC 1 Annex 1 of the draft rules for more information.)
- Retain existing requirements in SYSC 10 that go beyond the IDD minimum requirements – e.g. SYSC 10.1.4R, which includes an example of a type of conflict not present in the IDD.

2. Product oversight and governance (Chapter 8):

In this chapter the FCA sets out its proposed changes to implement the requirements of the POG Regulation. It already has broadly equivalent guidance for firms in the Responsibilities of Product Providers and Distributors for the Fair Treatment of Customers (RPPD) (which is based on high-level rules in the PRIN and SYSC). Therefore, the FCA does not anticipate significant changes for many UK firms.

The POG Regulation builds on the provisions of Article 25 of the IDD to provide more detailed requirements for firms.

The FCA proposes to:

- Change the definition of manufacturing used for the scope of PROD 1.4 and 4 to take into account the relevant provisions of the POG Regulation.
- Reproduce the POG Regulation requirements in the Handbook.
- Introduce new guidance to help firms understand the FCA's expectations of the IDD requirements based on the recitals to the POG Regulation to provide clarity on issues such as:
 - ➔ cases where distributors have a role in product manufacture;
 - ➔ target market assessment;
 - ➔ product testing; and
 - ➔ ongoing product reviews.

November 2017

- Retain existing RPPD guidance and copy it into PROD.
- Improve alignment between MiFID II and the IDD by introducing requirements based on the additional MiFID II provisions, adapted where necessary for firms conducting insurance business. This will cover areas such as:
 - ➔ product design considerations in assessing product charging structure and value for money;
 - ➔ ensuring manufacturers make available to any distributor information regarding the target market assessment undertaken; and
 - ➔ information that distributors should seek from manufacturers.

3. Changes to the Perimeter Guidance (Chapter 9):

The changes in this section are based on the Treasury's draft statutory instrument, which proposes legislative changes relating to the Regulated Activities Order (RAO).

The FCA proposes to:

- Revise the chapter to align defined terms with changes proposed in CP 17/7 and CP 17/23 (e.g. changing insurance mediation to insurance distribution; IMD to IDD).
- Revise existing, or include new, guidance to take account of changes proposed by the Treasury including:
 - ➔ describing the new exclusion proposed by HMT in the new Article 33B of the RAO. This offers a broad exclusion for persons who provide information about potential policyholders to insurance undertakings or insurance intermediaries and for providing specified information to potential policyholders; and
 - ➔ revising the conditions which need to be met for persons seeking to rely on Article 72B (activities carried on by a provider of relevant good or service) of the RAO.
- Update some of the guidance in PERG to make it more consistent with current regulation of insurance distribution activities (and the implementation of the IDD).
- Revise the guidance in PERG 5 to take into account the recent Financial Advice Market Review consultation, which proposed changes to PERG as a result of the Treasury's changes to the scope of Article 53 of the RAO.

4. Regulatory processes (Chapter 10):

The IDD sets certain standards that Member States must follow when regulating insurance distribution. Therefore this chapter sets out proposed changes to:

- the FCA's application forms to align these with IDD requirements;

November 2017

- parts of the Handbook that cover changes to these IDD processes, e.g. passporting;
- the requirements in respect of Appointed Representatives (ARs) carrying on insurance distribution business and members of Designated Professional Bodies.

Article 3 of the IDD contains provisions relating to the registration of intermediaries. There is no requirement for firms that are already registered under the IMD to re-register.

The authorisation process will remain substantively the same, with the exception that the FCA will now be required to deal with a complete application within three months.

ARs: the FCA is proposing amendments to SUP 12 in respect of ARs conducting insurance distribution business to reflect requirements relating to the registration of ARs and continued oversight by principal firms. The amendments include a requirement on the principal firm to collect additional information from the AR in accordance with the registration requirements of the IDD. The FCA is also considering if other changes are needed including to the AR notification forms. Further changes will be included in the FCA's quarterly consultation paper in December 2017, if necessary.

Passporting: The IDD makes various changes to the passporting regime and in particular, sets out a more detailed process than under the IMD. The differences between the IMD and the IDD include new powers for the FCA in relation to refusing a notification of an intention to establish a branch. The IDD also sets out in greater detail, the respective obligations of home and host Member States.

The activities that can be passported remain the same and the new notification regime will apply to firms passporting for the first time; existing passporting firms will not be required to submit a new notification (unless they intend to passport into a new Member State).

The FCA proposes to amend the relevant forms in SUP 13 relating to notifications to reflect the additional requirements set out in the IDD.

Article 7(1) of the IDD allows regulators, in cases where an *insurance intermediary's* primary place of business is located in a host state rather than its home state, to enter into agreements with each other for the host regulator to act as if it were the home state regulator with regard to certain provisions. This is a new provision with respect to financial services regulation being brought in by the IDD and will apply to IDD insurance intermediaries. (See SUP13A.6 and SUP 13A Annex 1G of the draft rules in CP17/33 for more information.) The Treasury has consulted on the legislation required in order to allow this process to take place if required and the FCA proposes to update SUP to cross-refer to the new FSMA provision.

Professional Firms: The FCA is proposing to make some consequential amendments within PROF to reflect changes to defined terms within its Handbook and the Treasury's draft statutory instrument. This will include a change to the disclosure specified in PROF 4.1.3R, which an exempt professional firm needs to give before it provides a service that includes insurance distribution activity.

The FCA is proposing to make amendments to the guidance in PROF 5, which sets out how the

November 2017

Handbook applies for authorised professional firms carrying on non-mainstream regulated activities – see Glossary definitions of ‘authorised professional firm’ and ‘exempt professional firm’. The FCA is also proposing amendments to COBS 18.11 and ICOBS 1 Annex 1 to ensure the relevant provisions of ICOBS and COBS that implement the IDD are applied to authorised professional firms.

The FCA proposes to continue with the existing approach to professional firms, meaning implementation of IDD rules that apply to non-mainstream activities but continuing to allow for equivalent rules of the professional body to apply instead. The requirements that apply to non-mainstream activities currently include both the fair, clear and not misleading rule and the rules on communications with clients. Both will be used to implement the Article 17(2) IDD requirement that firms communicate in a way that is clear, fair and not misleading. In relation to insurance distribution activities, these rules will in the future apply to authorised professional firms only where their professional body does not have an equivalent requirement to implement the IDD.

5. Additional changes, including consequential amendments, to other parts of the Handbook (Chapter 11):

The changes are largely administrative and do not reflect any change in policy.

The FCA proposes to amend the following Handbook modules:

- General Provisions (GEN)
- Fees manual (FEES)
- Client Assets sourcebook (CASS)
- Compensation sourcebook (COMP)

The FCA also proposes to copy out into SYSC for clarity the requirements of Article 10(8) of the IDD, which provide for insurance and reinsurance undertakings to:

- Approve, implement, and regularly review their internal policies and procedures for professional and organisational requirements - also see consultation paper 17/7;
- Identify a function to ensure the proper implementation of the above (and make the name of the person responsible available to the appropriate regulators); and
- Maintain appropriate records.

The FCA expects that firms will already be doing much of this to comply with their more general obligations in SYSC.

Next Steps

Comments on CP17/33 are requested by 25 November 2017. The FCA aims to publish a summary of responses and a Policy Statement in January 2018.

Links to the CPs, and corresponding Gem Briefing Notes, in the IDD series are provided below:

- [CP17/7](#) and [GBN 17/1](#)
- [CP17/23](#) and [GBN 17/3](#)
- [CP17/33](#)

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.