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Technical Advice on possible delegated acts concerning the Insurance Distribution Directive

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1. Underlying Strategic Objectives of EIOPA's policy proposals

1. On 24 February 2016, EIOPA was asked with a formal "Request for Advice" by the European Commission to provide technical advice on possible delegated acts to further specify the following provisions of the Insurance Distribution Directive (IDD):
   - Product Oversight and Governance, Article 25, IDD;
   - Conflicts of Interest, Articles 27 and 28, IDD;
   - Inducements, Article 29(2), IDD; and
   - Assessment of suitability and appropriateness and reporting, Article 30, IDD.

2. EIOPA places consumer protection, both through prudential and conduct of business regulation, at the centre of its strategy. Misconduct by firms may not only harm individual consumers, but may also have a wider prudential impact, posing a threat to the stability of the financial sector. Notwithstanding the fact that the Commission requests advice of a technical nature from EIOPA, EIOPA sees this advice as also actively contributing to the completion of a single rulebook on consumer protection, namely through the implementation of the IDD.

3. EIOPA has developed its policy proposals in view of EIOPA's strategic objectives and priorities as outlined in EIOPA's annual work programme for 2016[1], in particular the objective *"to ensure transparency, simplicity, accessibility and fairness across the internal market for consumers".*

4. In this respect, the focus is on the objectives, firstly, to *"provide a framework for better governance, suitability and accessibility of insurance products for consumers"* and, secondly to *"develop a framework for proper selling practices for direct sellers and intermediaries ensuring that advice to consumers is based on what best suits their needs and profiles"*.

5. The detailed policy proposals on product oversight and governance arrangements pursue the first objective to provide a framework for better governance of insurance products. They aim to ensure that the interests of customers are taken into consideration throughout the life cycle of a product, namely the process of designing and manufacturing the product, bringing it to the market and monitoring the product once it has been distributed. The inclusion of the provisions of EIOPA's Product Oversight & Governance (POG) Preparatory Guidelines in the technical advice, is in line with EIOPA's objective of the Guidelines providing early guidance and supporting national authorities and market participants with the implementation of POG requirements in preparation for the formal requirements provided for in the IDD.

6. The policy proposals on conflicts of interest, inducements as well as suitability/appropriateness assessment pursue the second objective. They aim to ensure that distribution activities are carried out in accordance with the best interests of customers and that customers buy insurance products which are suitable and appropriate for the individual customer.

7. Taking into consideration that inducements have the potential to cause a conflict of interest between the interests of distributors and their customers, the policy

proposals aim to ensure that any detrimental impact, stemming from the payment of inducements, on the quality of the service provided to the customer is mitigated from the outset.

8. The policy proposals further specifying the suitability/appropriateness assessment, ensure that the insurance intermediary or insurance undertaking obtains all relevant information necessary to assess whether a specific insurance-based investment product is suitable or appropriate for a specific customer. This approach helps, for example, to ensure that insurance intermediaries or insurance undertakings do not request more information from the customer than needed to provide good quality advice to the customer or information requests are not duplicated. This will further enhance the quality of service provided to the customer, thereby strengthening the framework for proper selling practices.

2. Background

1. On 30 June 2015, the European Parliament and the Council Presidency reached an agreement on a draft Directive establishing new improved rules on insurance distribution (the "Insurance Distribution Directive" – hereafter "IDD")[2]. Subsequent to this trilogue agreement being reached, the final legislative proposals of the IDD were approved by the European Parliament on 24 November 2015 and by the Council of the EU on 14 December 2015. The IDD was published on 2 February 2016 in the Official Journal of the European Union and entered into force on 23 February 2016.

2. The deadline for Member States transposing IDD is 23 February 2018. IDD effectively replaces the Insurance Mediation Directive (IMD)[3] as the IMD is repealed from the date of transposition. In addition, the amendments made to the Insurance Mediation Directive (IMD) via Article 91 of Directive 2014/65/EC ("MiFID II") were also deleted from the IMD with effect from 23 February 2016.

3. The IDD establishes new rules on insurance distribution and seeks to:

   - Improve regulation in the retail insurance market and create more opportunities for cross-border business;
   - Establish the conditions necessary for fair competition between distributors of insurance products, for example, through an extension of the Directive to direct sales; and
   - Strengthen consumer protection, in particular with regard to the distribution of insurance-based investment products (IBIPs).

4. Certain elements of the IDD need to be further specified in delegated acts to be adopted by the Commission. These include:

   - Product Oversight and Governance (Article 25(2));
   - Conflicts of Interest (Article 27 and 28(4));
   - Inducements (Article 29(4)); and
   - Assessment of suitability and appropriateness and reporting to customers (Article 30(6)).

5. EIOPA received a formal request ("Mandate")[4] from the European Commission on 24 February 2016 to provide technical advice to the Commission by 1 February 2017 on the possible content of the delegated acts.

6. The Commission invited EIOPA to build on the results of previous work that has already been carried out by EIOPA (e.g. EIOPA's previous technical advice on

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[2] Directive 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast): http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L0097&from=EN

[3] Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation

[4] Request for EIOPA Technical Advice on possible delegated acts concerning the Insurance Distribution Directive: https://eiopa.europa.eu/Publications/Requests%20for%20advice/I-EIOPA-2016-073%20COM%20Letter%20IDD%20%28GBE%29.pdf

conflict of interests in direct and intermediated sales of insurance-based investment products ("IMD 1.5")[5] and EIOPA's Preparatory Guidelines on Product Oversight & Governance arrangements by insurance undertakings and insurance distributors[6]).

7. In addition, EIOPA was invited under the Commission's mandate to achieve as much consistency as possible in the conduct of business standards for insurance-based investment products under IDD on the one hand and financial instruments under MiFID II on the other, where there is no fundamental difference in the wording of the provisions in the IDD and corresponding provisions in MiFID II.

8. As regards MiFID II, the following draft delegated acts are of relevance to the technical advice on the delegated acts on IDD and have been adopted by the Commission:

   - Draft Commission Delegated Directive supplementing Directive 2014/65/EU with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits[7];

   - Draft Commission Delegated Regulation supplementing Directive 2014/65/EU as regards organisational requirements and operating conditions for investment firms as defined terms of the purposes of that Directive[8].

9. In order to provide stakeholders with an early orientation on issues that will need to be addressed in the technical advice to the Commission and to gather feedback from the market, EIOPA published an online survey in January 2016 (the results of which have also been published online)[9].

Cost-benefit analysis

10. EIOPA was requested by the Commission to support its Technical Advice to the Commission with data and evidence on the potential impacts of proposals identified, including an assessment of the relative impacts of different options where this is appropriate. Where impacts might be substantial, the Commission requested, where feasible, that EIOPA provide quantitative data. The provision of such data and evidence will aid the Commission in preparing an Impact Assessment on the measures it shall adopt.

[5] https://eiopa.europa.eu/Publications/Opinions/EIOPA-15-135_Technical%20Advice%20%20Impact%20Assessment_conflicts_of_interest_version%20for%20COM%20(2).pdf
[6] Final Report on the Public Consultation on Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and distributors: https://eiopa.europa.eu/Publications/Reports/Final%20report%20on%20POG%20Guidelines.pdf
[7] COMMISSION DELEGATED DIRECTIVE (EU) …/… of 7.4.2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits
[8] COMMISSION DELEGATED REGULATION (EU) …/… of 25.4.2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive
[9] https://eiopa.europa.eu/Pages/Consumer-Protection/Online-survey-Call-for-Advice-from-EC-IDD.aspx

11. EIOPA has included a high-level assessment of possible impacts in Annex I. In developing this submission, EIOPA has also built upon the responses/data received to the public consultation on the costs and benefits of its proposals, the impact assessment work undertaken by the Commission for the revisions of the IMD and MiFID.

Next Steps

12. EIOPA will submit the Technical Advice and Impact Assessment to the European Commission by 1 February 2017 in accordance with the Commission's Request for Advice.

13. EIOPA will monitor the issues raised in this technical advice and assess, on the basis of sound evidence following the implementation of the Level 1 and Level 2 provisions in IDD in February 2018, the need for issuing guidance to further specify particular issues raised in this technical advice.

3. Product Oversight & Governance

Background/Mandate

Extract from the European Commission's request for advice

"EIOPA is invited to provide technical advice on detailed product oversight and governance arrangements for insurance undertakings and insurance intermediaries manufacturing and distributing insurance products in order to avoid and reduce, from an early stage, potential risk of detriment to customers' interest. The technical advice should identify when insurance undertakings and insurance intermediaries are acting as manufacturers, distributors, or both, and establish the level of responsibility of those actors. In addition, the technical advice should take into account the different types of distribution channels and differences in the size of the insurance undertaking or insurance intermediary concerned. EIOPA should also address the question of how the nature of the insurance product could be taken into consideration in terms of the practical application of the product oversight and governance arrangements.

With regard to product manufacturers, the technical advice should in particular deal with the arrangements of designing, approving and marketing insurance products, including the manufacturers' ongoing obligations as regards the life cycle of insurance products. In identifying the target market of customers, the technical advice should detail the level of granularity expected from manufacturers as regards the complexity of the insurance product and whether it is intended for mass market distribution. The technical advice should provide examples for activities that can be considered "manufacturing an insurance product for sale to customers".

With regard to insurance distributors, the technical advice should in particular deal with the arrangements for selecting insurance products for distribution to customers as well as for obtaining all the relevant information on the insurance product from the manufacturer in order to provide the distribution activities in accordance with the obligation to act in the best interest of the customer. EIOPA should assess whether distributors should be required to periodically inform the manufacturer about their experience with the product, or whether information on an incidental basis reflecting specific changes in the market would ensure sufficient protection of the customer's interest.

The technical advice should also specify the obligation for manufacturers and distributors of insurance products to regularly review their product governance policies as well as the products they manufacture, offer or recommend. The technical advice should refer to any appropriate actions to be taken by manufacturers and, where appropriate, distributors, to prevent and mitigate detriment to the interests of customers. Strengthening the role of management bodies and, where applicable, the compliance function, to ensure compliance with the arrangements should be duly considered."

1. The relevant provisions in the Insurance Distribution Directive are:

Recital 55:

"In order to ensure that insurance products meet the needs of the target market, insurance undertakings and, in the Member States where insurance intermediaries manufacture insurance products for sale to customers, insurance intermediaries should maintain, operate and review a process for the approval of each insurance product. Where an insurance distributor advises on, or proposes, insurance products which it does not manufacture, it should in any case be able to understand the characteristics and identified target market of those products. This Directive should not limit the variety and flexibility of the approaches which undertakings use to develop new products".

Article 25:

"1. Insurance undertakings, as well as intermediaries which manufacture any insurance product for sale to customers, shall maintain, operate and review a process for the approval of each insurance product, or significant adaptations of an existing insurance product, before it is marketed or distributed to customers.

The product approval process shall be proportionate and appropriate to the nature of the insurance product.

The product approval process shall specify an identified target market for each product, ensure that all relevant risks to such identified target market are assessed and that the intended distribution strategy is consistent with the identified target market, and take reasonable steps to ensure that the insurance product is distributed to the identified target market.

The insurance undertaking shall understand and regularly review the insurance products it offers or markets, taking into account any event that could materially affect the potential risk to the identified target market, to assess at least whether the product remains consistent with the needs of the identified target market and whether the intended distribution strategy remains appropriate.

Insurance undertakings, as well as intermediaries which manufacture insurance products, shall make available to distributors all appropriate information on the insurance product and the product approval process, including the identified target market of the insurance product.

Where an insurance distributor advises on, or proposes, insurance products which it does not manufacture, it shall have in place adequate arrangements to obtain the information referred to in the fifth subparagraph and to understand the characteristics and identified target market of each insurance product.

2. The Commission shall be empowered to adopt delegated acts in accordance with Article 38 to further specify the principles set out in this Article, taking into account in a proportionate way the activities performed, the nature of the insurance products sold and the nature of the distributor.

3. The policies, processes and arrangements referred to in this Article should be without prejudice to all other requirements under this Directive including those relating to disclosure, suitability or appropriateness, identification and management of conflicts of interest, and inducements.

4. This Article does not apply to insurance products which consist of the insurance of large risks."

Policy work of ESMA and EBA

2. For the purpose of cross-sectoral consistency, EIOPA has taken into account the initial policy work carried out in the Joint Committee of the ESAs on manufacturers' product oversight & governance processes[10] and policy work which ESMA and EBA developed with regard to product and oversight arrangements for credit institutions and investment firms, in particular ESMA's opinion on Structured Retail Products – Good Practices for product governance arrangements[11] and its technical advice to the Commission on MiFID II[12] and EBA's Guidelines on product oversight and governance arrangements for retail banking products[13].

3. Furthermore, it should be noted that the Commission recently published its proposal for a Delegated Directive specifying the product oversight and governance requirements which investment firms have to fulfil under MiFID II which was taken into consideration when drafting this Consultation Paper.[14]

Introduction

4. EIOPA has been invited by the Commission to provide technical advice on detailed product oversight and governance arrangements for insurance undertakings and insurance intermediaries manufacturing and distributing insurance products.

5. **EIOPA considers that product oversight and governance arrangements play a key role in customer protection by ensuring that insurance products meet the needs of the target market and thereby mitigate the potential for mis-selling.**

6. Product oversight and governance arrangements aim to ensure that the consumers interests are taken into consideration throughout the life cycle of a product, namely the process of designing and manufacturing the product, bringing it to the market and monitoring the product once it has been distributed. They are an essential element of the new regulatory requirements under IDD. Because of their relevance in terms of customer protection, it is of utmost importance that the new requirements are further detailed and specified.

7. Product oversight and governance arrangements are complementary to the information requirements and conducts of business rules applicable at the point of sale when carrying out distribution activities towards the individual customers.

8. It should be noted that EIOPA has already thoroughly elaborated policy proposals in the context of drafting Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and insurance distributors[15].

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[10] https://eiopa.europa.eu/Publications/Administrative/JC-2013-77__POG_-_Joint_Position_.pdf

[11] https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-332_esma_opinion_u_structured_retail_products_-_good_practices_for_product_governance_arrangements.pdf

[12] https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-549_-_consultation_paper_mifid_ii_-_mifir.pdf

[13] https://www.eba.europa.eu/documents/10180/1141044/EBA-GL-2015-18+Guidelines+on+product+oversight+and+governance.pdf

[14] COMMISSION DELEGATED DIRECTIVE (EU) .../...of 7.4.2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits: https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2031-EN-F1-1.PDF

[15] Final Report on Public Consultation on Preparatory Guidelines on product oversight product oversight and governance arrangements by insurance undertakings and insurance distributors: https://eiopa.europa.eu/Pages/Guidelines/Preparatory-Guidelines-on-product-oversight-and-governance-arrangements-by-insurance-undertakings-and-insurance-distributor.aspx

In the course of this process, EIOPA conducted two public consultations in order to appropriately involve market participants and stakeholders in the development of policy proposals.[16] This work has originally been initiated following the Joint Position of the European Supervisory Authorities on Manufacturers' Product Oversight and Governance Processes[17]. In its Request for Advice, the Commission has explicitly asked to "build on the results of previous work such as the Preparatory Guidelines".

9. After a thorough analysis of the legal requirements in Article 25, IDD and the request of the Commission for technical advice, EIOPA has come to the conclusion that the Preparatory Guidelines entail general principles which are consistent with the IDD and therefore can be used to further specify the product oversight and governance requirements in Article 25, IDD. However, following the analysis of the Commission request, EIOPA has identified several issues which have not yet been addressed by the Preparatory Guidelines so far. For that reason, EIOPA has developed additional policy proposals which amend and have been consolidated with the existing policy proposals based upon the Preparatory Guidelines.

[16] First public consultation:
https://eiopa.europa.eu/Pages/Consultations/CP-14150-Guidelines-on-product-oversight-amp;-governance-arrangements.aspx
Second public consultation:
https://eiopa.europa.eu/Pages/Consultations/EIOPA-CP-15-008-Consultation-Paper-on-POG-Guidelines-for-insurance-undertakings-and-insurance-distributors-.aspx
[17] https://www.eba.europa.eu/documents/10180/15736/JC-2013-77+(POG+-+Joint+Position).pdf

Analysis

10. The policy proposals distinguish between:

    (i) Policy proposals for insurance undertakings and insurance intermediaries which manufacture insurance products for sale to customers (also referred to as "product oversight and governance arrangements "), and

    (ii) Policy proposals for insurance distributors which distribute insurance products which they do <u>not</u> manufacture (also referred to as "product distribution arrangements").

11. This is in line with the approach proposed by the Commission with regard to the draft Delegated Directive specifying the product oversight and governance requirements which investment firms have to fulfil under MiFID II.[18] For the purpose of developing a consistent set of rules for the insurance sector, it is worth noting that the Commission proposes implementing measures with a high level of detail for both manufacturers, as well as distributors which are based upon high-level principles or specific obligations in MiFID, similar to those required under IDD.

12. Article 25 of the IDD introduces general principles regarding the product oversight and governance requirements, for insurance undertakings and insurance intermediaries which manufacturer insurance products for sale to customers, and for insurance distributors which distribute insurance products which they do not manufacture.

13. EIOPA would like to point out that the product oversight and governance arrangements applicable to insurance undertakings that manufacture insurance products are closely linked to the requirements regarding the system of governance as laid down in Articles 40 and 41(1) of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (hereinafter "Solvency II"). These Articles require insurance undertakings to have a sound and prudent management of the business under a risk-based approach including an appropriate risk management system.

14. In order to further specify the general principles on product oversight and governance requirements which underlie Article 25, IDD, EIOPA considers it important to define in more detail, the arrangements regarding internal processes, functions and strategies for designing and bringing products to the market, monitoring and reviewing them over their life cycle. The arrangements differ depending on the question whether the regulated entities are acting as a manufacturer and/or distributor of insurance products. In the case of manufacturers, these steps include:

    (i) identifying a target market for which the product is considered appropriate;

    (ii) identifying market segments for which the product is not considered appropriate;

    (iii) carrying out product analysis to assess the expected product performance in different stressed scenarios;

    (iv) carrying out product reviews to check if the product performance may lead to customer detriment and, in case this occurs, take actions to change its characteristics and minimise the detriment;

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[18] https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2031-EN-F1-1.PDF

(v) identifying the relevant distribution channels taking into account the characteristics of the target market and of the product;

(vi) verifying that distribution channels act in compliance with the manufacturer's product oversight and governance arrangements; and

(vii) the provision of appropriate information on the product and the product approval process to insurance distributors.

15. The product oversight and governance arrangements should be generally applied to all insurance undertakings and all insurance intermediaries manufacturing insurance products, including any natural or legal person pursing the activity of insurance distribution, independent from the question whether these activities are pursued by an independent broker or by a tied agent, provided that they fall into the scope of the IDD. However, product oversight and governance arrangements need to be proportionate to the level of complexity and the risks related to the products as well as the nature, scale and complexity of the relevant business of the regulated entity.

16. Product oversight and governance arrangements are without prejudice to basic principles in insurance, in particular the principles of solidarity, mathematical methods and risk pooling. The interests of customers that need to be taken into account when designing products following the product oversight and governance arrangements, comprise individual and collective policyholder interests which need to be duly balanced.

a. Analysis for arrangements applicable to manufacturers

17. The arrangements apply to all insurance undertakings and insurance intermediaries which manufacture any insurance product for the sale to customers.

Establishment and objectives of product oversight and governance arrangements

18. The manufacturer should establish, implement and review product oversight and governance arrangements that set out appropriate measures and procedures aimed at designing, monitoring, reviewing and distributing products for customers. The product oversight and governance arrangements should aim to prevent or mitigate customer detriment, support proper management of conflicts of interest and should ensure that the customer's demands and needs, and if relevant their knowledge and experience in the investment field, their financial situation and investment objectives and other relevant characteristics are duly taken into account already at the stage when the insurance products are designed and manufactured.

19. Good implementation of product oversight and governance arrangements should result in products that:

- Meet the needs of one or more identified target markets;
- Deliver fair outcomes for customers; and
- Are sold to customers in the target markets by appropriate distribution channels.

20. An application of product oversight and governance arrangements should also ensure that all relevant staff members have knowledge of these arrangements and

monitor them for their respective area of activities. It also ensures that any changes to the arrangements are promptly communicated to them.

Role of Management

21. The administrative, management or supervisory body of the manufacturer or equivalent structure (in the case of two tier systems) is ultimately responsible for the establishment, subsequent reviews and continued compliance of the product oversight and governance arrangements. The manufacturer's administrative, management or supervisory body also ensures that the product oversight and governance arrangements are appropriately designed and implemented into the governing structures of the manufacturer.

22. The product oversight and governance arrangements, as well as any material changes to those arrangements, are subject to prior approval by the manufacturer's administrative, management or supervisory body or equivalent structure.

Acting as Manufacturer

23. Article 25(1), IDD acknowledges that, in certain circumstances, insurance intermediaries can be involved in the manufacturing of insurance products. As a consequence and in order to guarantee a level playing field, the IDD extends the product oversight and governance arrangements which apply for insurance undertakings manufacturing insurance products to insurance intermediaries which pursue such activities as well. Likewise, insurance undertakings do not have to meet the obligations applicable for manufacturers laid down in Article 25 (1) (1) – (5) of the IDD for insurance products which the insurance undertakings do not manufacture, but distribute, only. In this case, the insurance undertakings are only subject to Article 25(1)(6) of the IDD introducing specific product distribution arrangements for distributors of insurance products.

24. EIOPA considers it important to provide further guidance under which circumstances the activities of an insurance distributor should be considered as manufacturing and further specifies what "manufacturing" means. Therefore, EIOPA considers it important to outline and specify under which conditions and based upon which criteria, an insurance intermediary can be considered as acting as a manufacturer. The following explanatory notes on the characteristics of acting as manufacturer refer to insurance intermediaries, only. They apply, accordingly, in the case that insurance undertakings manufacture an insurance product without being the sole insurance undertaking – the insurance product might be a 'combined product' that includes coverage of certain risks by different insurance undertakings.

25. Taking into account the principle of proportionality, it is clear that not all kinds of involvement or influence of an insurance intermediary in the design and manufacturing of an insurance product should be considered as manufacturing.

26. Generally speaking, it can be expected that large brokers, such as managing general agents, could more easily fall under the definition of "manufacturer" in comparison with tied agents – especially those who distribute products on behalf of a sole company. However, it is important to note that the IDD makes no distinction between brokers and tied agents, adopting purely an activity-based definition of an "insurance intermediary".

27. Taking into account the characteristics of the insurance distribution and the specific role of insurance undertakings, it should be assumed that an intermediary can be

considered a manufacturer only when it has a decision-making role in the design and development of insurance products.

28. This depends on the specific circumstances of the individual case and an overall analysis of the respective activities that the insurance intermediary performs with regard to a specific product.

29. In particular, EIOPA considers that the following activities, taken on their own, cannot be considered adequate in order to qualify an intermediary as a manufacturer:

- The mere call for tender for insurance undertakings to cover specific risks required by the insurance intermediary is not relevant when the insurance intermediary does not play any further role in the design of the product;
- The mere possibility to discount the commission or fee paid to the insurance intermediary;
- The activity of handling customer claims;
- The personalisation and adaptation of existing insurance products in the course of insurance distribution activities to the individual customer, in particular cases such as the mere opportunity to choose between different lines of products, contractual clauses and options, recommendation of asset, with regard to a product already designed by the insurance undertaking;
- Tailor-made contracts which are designed at the request of a customer to meet the individual demands and needs of that customer;
- Providing feedback and exchanging information on the distribution of insurance products between manufacturer and distributor.

30. On the other hand, EIOPA is of the view that a decision-making role of the insurance intermediary can be exercised through one of the following practices:

(i) Design of a new product: the following situations can be included in the notion of “design” if the insurance intermediary has a decision-making role:

a) The insurance intermediary takes the initiative to design and define the main elements of a specific insurance product;

b) The insurance intermediary defines a certain kind of coverage not already existing in the market for a particular type of customer and asks the undertaking to provide it; or

c) The undertaking provides the coverage and establishes the premium under the mandate of the insurance intermediary.

(ii) A change of significant elements of an existing product: this condition occurs when the coverage, premium, costs, risks, target market or benefits of a type of contract are modified by the insurance intermediary. In all these cases, as the undertaking still provides the coverage, any change should be made under the mandate/authorization of the undertaking and subject to its approval.

31. A decision-making role shall be assumed, in particular, where the insurance intermediary autonomously determines the essential features and main elements of an insurance product, including the coverage, costs, risks, target market or compensation and guarantee rights of the insurance product, which are not substantially modified by the insurance undertaking assuming the underwriting risks. A typical example where a decision-making role by the insurance

intermediary can be assumed are cases where an insurance broker with a high specialisation in a segment of the insurance market, designs a sophisticated insurance product for a market niche based upon his experience and expertise in the specific market (white labelling).

32. **It should be highlighted that the presence of one of these activities may not be sufficient to qualify the insurance intermediary as a manufacturer, but this conclusion should be based upon an overall analysis of the specific activity of the intermediary which should be carried out by the intermediary on a case-by-case basis for each product designed**.

33. A relevant criterion which should be taken into consideration is further the question whether the product is sold under the brand name of the insurance intermediary and whether the insurance intermediary owns the intellectual property rights in the brand name of the product, and whether the intermediary's remuneration depends on the overall performance of the product, profit sharing arrangements, for example.

34. However, it should be noted that, even in cases where an insurance intermediary is considered as acting as a manufacturer, the insurance undertaking providing the coverage (i.e. insurance provider), remains fully responsible to the customer for the contractual obligations resulting from the insurance product, while each co-manufacturer independently remains responsible to comply with the product oversight and governance arrangements of a manufacturer as laid down in Article 25, IDD.

35. Therefore, the insurance undertaking providing the coverage should always be considered a co-manufacturer for the purposes of the application of POG requirements, its role and contractual responsibilities with regard to the customer and its role in the approval process of the insurance product.

36. Co-manufacturing partnerships should necessarily be established in a written agreement, so that competent authorities are in a position to supervise collaboration arrangements.

37. In this case, through a necessary and proportionate collaboration between the two manufacturers (the insurance undertaking and the insurance intermediary/manufacturer *de facto*), all the arrangements and forms of collaboration necessary should be put in practice in order to comply with the product governance requirements for each product co-designed.

38. Whereas the collaboration agreement sets out how the co-manufacturer have bilaterally agreed upon their respective tasks, it cannot limit the respective civil law responsibilities towards the customer or the respective regulatory responsibilities of the parties towards the competent authorities.

39. As far as insurance undertakings are manufacturers and at the same time distributors of their own insurance products, they have to fulfil with the product oversight and governance arrangements for manufacturers of insurance products, only. Insurance undertakings only have to fulfil the product distribution arrangements where they distribute insurance products they do not manufacture.

Target Market

40. The manufacturer shall identify the group of customers for whom the insurance product is compatible (target market) and only design and bring to the market products with features which are aligned with the demands and needs of the target market the manufacturer has identified.

41. When assessing whether a product is compatible for a group of customers the manufacturer should take into account criteria such as the demands and needs, and, where relevant with regard to the complexity and nature of the product, the knowledge and experience in the investment field, financial situation, the investment objectives and the financial literacy of the typical customer of the target market.

42. EIOPA considers it important to take account of the principle of proportionality when considering the granularity of the target market. Insurance products are quite heterogeneous and their complexity varies. Some insurance products are obligatory for consumers and product choice would be limited. This is, for example, the case with motor insurance products. Some insurance products are complex such as many insurance-based investment products (IBIPs). All products differ and, therefore, the granularity of the target markets can differ depending on the complexity and nature of the product and the risk of consumer detriment. There may be product limitations which are simple to understand, but would mean that the target market assessment would need to be more granular in detail.

43. Even with compulsory motor insurance products, for example, not all customers would need 'fully comprehensive' coverage meaning that a 'fully comprehensive' product may not be compatible for all customers. Therefore, specification of the target market should be more meaningful than simply describing it as 'mass market' suitable for any type of insurance product.

44. This approach is in line with the principles underlying the individual customer assessments in IDD, such as the "demands and needs" test and the suitability and appropriateness tests. The criteria used in these tests are generally relevant to define the target market since the target market is an abstract description of the characteristics of a group of consumers, whereas the individual assessments as laid down in the IDD, verify whether the insurance product fits with the specificities of the individual customer.

45. Examples of criteria which could be considered to determine the target market are detailed below. It should be noted that the examples are not exhaustive and non-binding. If necessary, manufacturers should add additional categories based on the specific product and risk profile.

46. The criteria differ depending on the type of insurance product and the insurance coverage provided. Not all criteria which are relevant for one type of insurance product might be relevant for another type of insurance product as well. The level of detail will depend on the complexity of the product and some criteria may not be appropriate for less complex products.

47. Examples for all insurance products:

- the level of the target market's knowledge and understanding of the complexity of the product,
- the objectives, demands and needs of the customers belonging to the target market.

48. Examples, in particular, for IBIPs:

- the age of the customers belonging to target market;
- the occupational situation of the customers belonging the target market;
- the level of risk tolerance of the customers belonging the target market;
- the financial situation of the customers belonging the target market;

- the financial and non-financial objectives and investment horizon of the customers belonging the target market.

49. Examples, in particular, for health insurance:
    - The occupational situation of the customers belonging the target market;
    - The social security coverage of the customers belonging the target market;
50. Examples for other insurance products:
    - Risks, coverage, needs etc.
51. The level of knowledge and understanding of the product could also include experience of targeted consumers with similar products. The customer's financial situation could, for example, be relevant for the sale of Payment Protection Insurance (PPI). Here, it could be considered whether the product is suitable for consumers with a temporary employment contract or if it is only suitable for consumers with a fixed contract.
52. The policy proposal makes clear that identifying for whom the product may be suitable, is helpful in order to obtain a clear picture of cases where it may be rather questionable for whom the product would not be suitable (e.g. a life insurance policy running for 30 years for a 97-year-old person).
53. If an insurance product is not compatible with the demands and needs, characteristics as well as investment objectives of a specific group of customers, the manufacturer shall also identify the target market to which the insurance product should not be distributed, if relevant from a consumer protection perspective and, in particular, for insurance-based investment products.
54. The level of granularity cannot uniformly be defined for all products as in the insurance market there is a wide range of products which differ in characteristics and complexity. The features listed above may not be appropriate for all insurance products and should be applied using a risk-based approach.

Skills, knowledge and expertise involved in designing products

55. According to the general principle of good governance stated in Article 258(1)(e) of Commission Delegated Regulation (EU) No 2015/35 under Solvency II, insurance undertakings are required to *"employ personnel with the skills, knowledge and expertise necessary to carry out the responsibilities allocated to them properly"*. In that respect, the manufacturer should ensure that relevant personnel involved in designing products should possess the necessary skills, knowledge and expertise in order to properly understand the product's main features and characteristics as well as the interests, objectives and characteristics of the target market.
56. As necessary, the staff involved in designing products should receive, for instance, appropriate professional training to understand the characteristics and risks of the relevant products and the interests, objectives and characteristics of the target market.

Product Testing

57. Before a product is brought to the market, or if the target market is changed or changes to an existing product are introduced, the manufacturer should conduct appropriate testing of the product including, if relevant and, in particular, for insurance-based investment products, scenario analyses in order to align the product with the interests of the target market. The range of scenario analysis

needs to be proportionate to the complexity of the product, its risks and the relevance of external factors with respect to the product performance.

58. Keeping in mind the objectives of the defined target market, the assessment could imply considering the following questions:

    - What if assumptions change, for instance if market conditions deteriorate?
    - Is the price of the policy in balance with the worth of the underlying? For instance, is it possible to conclude an all-risk policy for an old car?
    - What if certain circumstances during the lifetime of the product change? For instance, what happens with the premium of a Payment Protection Insurance (PPI) policy if a person becomes unemployed, disabled or experiences other life events? What are the consequences for the coverage of a PPI product when a married couple divorces?
    - What happens to the (guaranteed) coverage (insured amounts) of a fire and theft insurance when the income changes?

59. In addition to the question above, more specifically for <u>insurance-based investment products</u>, the assessment could imply considering also the following questions:

    - What would happen to the risk and reward profile of the product following changes to the value and liquidity of underlying assets?
    - How is the risk/reward profile of the product balanced, taking into account the cost structure of the product?
    - When a product benefits from a certain tax environment or other condition; what happens if these conditions change?
    - What are the terms and conditions, and how do they affect the outcome of the product?
    - What will happen when the manufacturer faces financial difficulties?
    - What will happen if the customer terminates the contract early?

60. In addition to the questions above, more specifically for <u>pure protection life insurance products</u>, the assessment could imply considering also the following questions:

    - What if the premises change, for instance, the mortality rate or the technical interest rate increases?
    - Does the benefit cover sufficiently future needs of beneficiary?

61. In the case of <u>non-life insurance</u>, the assessment could imply considering the following questions:

    - What is the expected claims ratio and the claims payment policy? What if it is higher or lower than expected? Do the expected claims ratio and claims payment policy suggest that the product is of benefit to customers?
    - Does the coverage of one product potentially overlap with the coverage of another product?
    - Does the coverage meets sufficiently future needs of target market? How is the coverage updated in terms of reflecting future needs of target market?
    - Do customers understand the terms and limitations of the contract?

- Would the manufacturer be able to cope with a large amount of customers? Is the amount of staff sufficient enough to deal with a large amount of requests from customers?

62. EIOPA believes that especially the claim ratio is an important criterion to assess whether an insurance product is of added value for consumers, but agrees that other indicators may be considered for the sake of a comprehensive assessment. EIOPA does not pursue the intention to introduce a general price control.

63. On the basis of the PRIIPs Regulation[19], EIOPA considers that the manufacturer of an insurance-based investment product will be required to produce a Key Information Document (KID) containing information on the risk and reward profile of the product. Performance scenarios expected to be presented in the KID and the range of scenarios used for testing the product may present similarities; however, may not necessarily be identical. Performance scenarios are disclosed to customers whereas scenarios for testing the products cover a large range of factors that determine the performance of the product.

Product monitoring and review

64. The manufacturer should continuously monitor and regularly review the product to identify crucial events that could materially affect the main features, the risk coverage and the guarantees of the products, e.g. the potential risk or return expectations. When reviewing existing products, the manufacturer should further consider if the product remains aligned with the demands and needs, and where relevant, with regard to the complexity of the product, the knowledge and experience in the investment field as well as the financial situation and investment objectives of the typical customer of the target market.

65. The IDD requires insurance undertakings to regularly review the insurance products they offer or market. The issue of the frequency of the review was discussed in the impact assessment of the EIOPA Preparatory Guidelines and more specifically, whether the frequency of the review should be determined. The pros and cons of both options were discussed and EIOPA concluded that, given the wide range of products offered as well as the differences between the firms selling the products, that the frequency of the reviews should not be uniformly determined.

66. Instead, the decision with regards to the frequency of the review, should be left to the manufacturer (and the distributor, where appropriate). In doing so, the manufacturer should take into consideration the product specificities. This option allows each manufacturer to adapt the correct frequency of the review process in line with the timing of the internal design product, also taking into account the size, scale and complexity of the insurance undertaking and of the different products it manufactures.

67. It is important that the manufacturer and the distributor coordinate their reviews and should aim to have similar frequencies of reviews. Manufacturers should consider: i) what information they need to review a product and ii) what information they already hold. If they need additional information from distributors, they can choose how to gather that information and from which distributors.

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[19] Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs)

68. However, EIOPA considers that the delegated acts should specify that the manufacturer should decide how regularly their products should be reviewed: This should be based on relevant factors such as the nature of the product and the target market or if they become aware of any event that could materially affect the potential risk to investors.

Remedial action

69. EIOPA considers manufacturers and distributors should take appropriate action when they become aware of an event that could materially affect the potential guarantees to the identified target market. However, given the wide range of products offered as well as the differences between the undertakings selling the products, EIOPA considers that there should be no specific action to be taken in all cases and that flexibility should be given to manufacturers and distributors to decide what steps they need to take, based on the circumstances of the case.

70. Nevertheless, manufacturers and distributors should make their best effort to identify events that would materially affect the potential expectations regarding product guarantees and, when such an event occurs, they should take appropriate action on a case-by-case basis. These actions could be the following (the list is not exhaustive):

- the provision of any relevant information on the event and its consequences on the product to the customer, or the distributors of the product if the firm does not offer directly the product to the customer;
- changing the product approval process;
- changing the product;
- proposing a new product to the customer;
- changing the target market;
- stopping further issuance of the product;
- contacting the distributor to discuss a modification of the distribution process;
- terminating the relationship with the distributor;
- informing the relevant competent authority; or
- informing the customer.

71. Furthermore, the manufacturer needs to take appropriate action whenever he becomes aware that the product might cause detriment to customers. This might be the case during the regular product monitoring exercise or the product review, but also when he is, for instance, informed by the insurance distributor or through a complaint.

72. The product lifetime is understood as capturing the entire life cycle of a product which begins at the moment when the product is being designed and only finishes once there is no product left on the market. It covers situations when the product is no longer being sold, but there are still customers who own the product. The end of the life cycle of the product is reached only when the last product has been withdrawn from the market.

73. For example, remedial action needs to be taken when the product no longer meets the general needs of the target market or when the product performance is significantly different from what the manufacturer originally expected.

74. As a general principle, and, in accordance with national legal framework, the manufacturer can only make changes to the product that are consistent with the interests, objectives and characteristics of the already existing target market and these changes do not have an adverse impact on the customer to which the product has been sold already.

75. In order to prevent customer detriment efficiently, it might also be necessary that the manufacturer notifies the remedial action taken to the insurance intermediary involved and to the customer in case of direct sales. This might be the case where the risk profile of a product has changed due to market developments and the product is no longer in line with the interests, objectives and characteristics of the target market.

Distribution channels

76. The manufacturer needs to select insurance distributors that have the necessary knowledge, expertise and competence to understand the product features and the characteristics of the identified target market, correctly place the product in the market and give the appropriate information to customers.

77. If the manufacturer identifies problems with the selected distribution channels (i.e. when the insurance distributor is offering the product to customers for whom it is not compatible) they need to take appropriate action. In the case of independent insurance intermediaries, manufacturers might, for instance, need to consider ceasing making available the relevant products to the insurance intermediary not meeting the product oversight and governance objectives of the manufacturer.

78. Article 25(1)(3) IDD requires manufacturers to take reasonable steps to ensure that the insurance product is distributed to the identified target market. In order to achieve this goal, it is important that the manufacturer monitors and examines on a regular basis whether the product is distributed to customers belonging to the relevant target market in order to assess whether the steps taken are appropriate and efficient.

79. However, it should be emphasised that the monitoring obligation is limited to the assessment whether the distribution channels carry out their distribution activities in accordance with the product oversight and governance arrangements established by the manufacturer, in particular whether insurance products are distributed to the target market identified by the manufacturer. The monitoring obligation does not extend to the general regulatory requirements which distributors have to fulfil when carrying out insurance distribution activities for the individual customers (in particular, the conduct of business rules as laid down in IDD). The monitoring activities should be reasonable taking into consideration the specificities and nature of the respective distribution channels.

Information to be provided to the distributors

80. The IDD rules on POG arrangements aim to strengthen the exchange of product-related information between the manufacturer and distributor.

81. According to Article 25(1)(5), IDD, insurance undertakings, as well as insurance intermediaries which manufacture insurance products, shall make available to distributors all appropriate information on the insurance product and the product approval process, including the identified target market of the insurance product.

82. Vice-versa, according to Article 25(1)(6), IDD, where the insurance distributor advises on or proposes insurance products which it does not manufacture, it shall

have in place adequate arrangements to obtain the information (referred to above) and to understand the characteristics and identified target market of each insurance product.

83. The purpose of these requirements is to ensure that the distributor receives all necessary information on the product and the product approval process from the manufacturer which is considered as an important prerequisite in order to carry out the insurance distribution activities in accordance with the best interests of their customers.

84. The purpose of the requested exchange of information between manufacturers and distributors is laid down in Recital 55, IDD, stating that the distributor should *"in any case be able to understand the characteristics and identified target market of each insurance product"*.

85. The importance of having appropriate knowledge and competence is furthermore emphasised in the general rule of Article 10, IDD requiring insurance distributors and their employees carrying out insurance distribution activities, to possess appropriate knowledge and ability in order to complete their tasks and perform their duties adequately.

86. However, the obligation of the manufacturer to make available "all appropriate information" and the obligation of the distributor to obtain that information as laid down in Article 25 of IDD is generally abstract and high-level.

87. Besides the identified target market, the IDD neither specifies the information which the manufacturer is required to make available to the distributor nor specifies the consequences if the distributor does not receive all necessary information. In view of the importance of this matter, EIOPA considers it important to further specify the information, which the distributor should obtain in order to be in a position to distribute the insurance products to its customers further.

88. In view of the variety of insurance products and product features, EIOPA does not consider it appropriate to propose an exhaustive list of information which the distributor should obtain. Instead, EIOPA proposes to introduce a high-level principle combined with specific information details, which should be understood as the bare minimum (see policy proposal below).

89. Taking into consideration the principle of proportionality, the level of information details should take into account the complexity and comprehensibility of the products, the risks of the product and the services provided with regard to the respective products (advice, non-advised sale, execution-only).

90. With regard to the consequences in cases where the distributor fails to obtain all relevant information on the product from the manufacturer or from public sources, EIOPA notes that the legal text of the IDD does not specify what the consequence should be. From a customer protection point of view, however, EIOPA would consider it important that the distributor is pre-emptively prevented from recommending insurance products in order to avoid any detriment to customers' interests from the outset. This would be complementary to the empowerment of competent authorities to impose (ex post) sanctions for infringing the conduct of business requirements set out in Chapter VII of IDD.

Documentation of product oversight and governance arrangements

91. EIOPA considers it important that insurance intermediaries and insurance undertakings keep appropriate records about all relevant action taken in relation to the product oversight and governance arrangements and make available those

records to the competent authorities upon request if needed for supervisory purposes.

b. Analysis for arrangements applicable to insurance distributors

92. The arrangements apply to all insurance undertakings, insurance intermediaries and ancillary insurance intermediaries advising or proposing insurance products, which they do not manufacture.

Establishment and objectives of distribution arrangements

93. EIOPA considers that insurance distributors need to establish appropriate measures and procedures with regard to the insurance products they intend to distribute. Contrary to manufacturer's arrangements, insurance distributors are not required to design and subsequently to review the products, but to take the necessary steps in preparation of the distribution of insurance products to the customer (such as obtaining all relevant information from the manufacturer and defining a distribution strategy).

94. The distribution arrangements should aim to prevent, or, if not, mitigate, customer detriment, support a proper management of conflicts of interests and should ensure that the customer's demands and needs, and, if relevant, their knowledge and experience in the investment field, their financial situation and investment objectives are duly taken into account.

95. According to this approach, insurance distributors need to consider to which extent the product choice gives rise to the risk of conflicts of interest and if so, which measures should be taken in order to ensure that the distribution activities are carried out in accordance with the best interests of the customer. This might also imply that distributors abstain from distributing specific insurance products, for example, in cases where products do not offer any value to the customer, but only a high commission to the distributor.

Role of Management

96. EIOPA emphasises that the ultimate responsibility with regard to the product distribution arrangements lies with the insurance distributor's administrative, management or supervisory body or equivalent structure even though it is possible that the tasks are delegated either internally or even externally (e.g. in cases of outsourcing). In particular, the ultimate responsibility for the organisational measures and procedures lies with the management of the distributor which is registered and responsible for the distribution activities. For sole traders, it is evident that they bear the responsibility for their entire business.

Obtaining all relevant information on the insurance product from the manufacturer

97. An important prerequisite to setting up a distribution strategy is that the insurance distributor has appropriate knowledge about the approval process of the manufacturer, in particular the target market of the individual insurance product, as well as about all other necessary information on the product from the manufacturer in order to fulfil its regulatory obligations towards the customer. This information helps the insurance distributor to select the insurance products the

insurance distributor intends to distribute and to assess to which customers the insurance distributor may advertise and promote the individual insurance products.

98. According to this approach, the insurance distributor should establish appropriate arrangements to obtain from the manufacturer all relevant information on the product which is necessary to carry out its distribution activities.

Distribution strategy

99. Where the insurance distributor sets up or follows its own distribution strategy, this strategy needs to be consistent with the target market identified by the manufacturer of the respective insurance product. In particular, this means that the distribution strategy should not foresee insurance products being distributed to customers which are not part of the target market identified by the manufacturer. The distribution strategy may also outline circumstances under which the distribution of insurance products to customers outside of the target market is permitted exceptionally.

100. The target market identified by the manufacturer specifies the group of customers to whom the insurance products should generally be distributed. On an exceptional basis, the insurance distributor may distribute insurance products to a customer, who does not belong to the identified target market, provided that the insurance distributor can prove that the respective insurance product meets the demands and needs of the individual customer, and, in the case of insurance-based investment products, is appropriate or suitable for the customer.

Informing the manufacturer

101. For the sake of customer protection, EIOPA considers it crucial to enhance the exchange of information between manufacturer and insurance distributor to facilitate market monitoring by the manufacturer. This does not mean that the insurance distributor needs to report every sale to the manufacturer or that the manufacturer needs to confirm that every transaction was made with respect to the correct target market, but the insurance distributor should communicate the relevant information such as the amount of sales made outside the target market, summary information on the customer or a summary of the complaints received with regard to a specific product.

Documentation of distribution arrangements

102. EIOPA considers it important that insurance distributors keep appropriate records about all relevant action taken in relation to the product oversight and governance arrangements and make available those records to the competent authorities upon request, if needed for supervisory purposes.

Technical Advice

1. Policy proposals for insurance undertakings and insurance intermediaries which manufacture insurance products for sale to customers

Establishment of product oversight and governance arrangements

1. Insurance undertakings and insurance intermediaries which manufacture any insurance product for sale to customers (the "manufacturer") shall maintain, operate and review product oversight and governance arrangements that set out appropriate measures and procedures aimed at designing, monitoring, reviewing and distributing products for customers, as well as taking action in respect of products that may lead to detriment to customers (product oversight and governance arrangements).
2. The product oversight and governance arrangements need to be proportionate to the level of complexity and the risks related to the products as well as the nature, scale and complexity of the relevant business of the manufacturer.
3. The manufacturer shall set out the product oversight and governance arrangements in a written document ("product oversight and governance policy") and make it available to its relevant staff.

Objectives of the product oversight and governance arrangements

4. The product oversight and governance arrangements shall aim to prevent or mitigate customer detriment, support a proper management of conflicts of interests and shall ensure that the customer's demands and needs, and, if relevant, their knowledge and experience in the investment field, their financial situation and investment objectives are duly taken into account.

Role of management

5. The manufacturer's administrative, management or supervisory body or equivalent structure responsible for the manufacturing of insurance products shall endorse, and be ultimately responsible for, the establishment, implementation, subsequent reviews and continued internal compliance with the product oversight and governance arrangements.

Acting as manufacturer

6. Based upon an overall analysis of the specific activity of the insurance intermediary, an insurance intermediary shall be considered as a manufacturer if the insurance intermediary has a decision-making role in designing and developing an insurance product for the market. This shall accordingly apply for insurance undertakings which do not provide coverage for an insurance product, but have a decision-making role in designing and developing this insurance product.
7. A decision-making role shall be assumed, in particular, where the insurance distributor autonomously determines the essential features and main elements of an insurance product, including the coverage, costs, risks, target market,

compensation and guarantee rights of the insurance product, which are not substantially modified by the insurance undertaking assuming the underwriting risks. A decision-making role shall be assumed, for example, in instances where an insurance distributor designs a sophisticated insurance product for a market niche based upon his experience and expertise of the specific market.

8. Activities which relate to the personalisation and adaptation of existing insurance products in the course of insurance distribution activities to the individual customer, as well as the design of tailor-made contracts at the request of one customer shall not be considered as activities of manufacturing, in particular cases such as the mere opportunity to choose between different lines of products, contractual clauses and options, individual premium discounts, recommendation of asset, with regard to a product already designed by the insurance undertaking, or the exchange of information between manufacturer and distributor related to these products.

9. Where an insurance intermediary or insurance undertaking is considered as a manufacturer according to paragraph 6, it shall define in a written agreement with the insurance undertaking issuing the insurance product, their collaboration and their respective roles, in particular, clarifying the procedures through which the two parties agree on the identification of the target market. The insurance undertaking issuing the insurance product remains fully responsible to the customer for the coverage provided, while both independently remain responsible for complying with the product oversight and governance arrangements of a manufacturer, as laid down in Article 25, IDD.

Review of product oversight and governance arrangements

10. The manufacturer shall regularly review the product oversight and governance arrangements to ensure that they are still valid and up to date and the manufacturer shall amend them, where appropriate.

Target market

11. The manufacturer shall identify the target market for each insurance product and specify the group of customers for whom the insurance product is compatible. As the identification of the target market describes a group of customers sharing common characteristics at an abstract and generalised level, it has to be distinguished from the individual assessment whether an insurance product is consistent with the demands and needs, and where applicable whether the insurance product is suitable and appropriate for the individual customer a the point of sale.

12. For the assessment whether an insurance product is compatible for a group of customers, the manufacturer shall only design and bring to the market products with features which are aligned with the demands and needs of the target market, and, where relevant with regard to the complexity and nature of the product, the knowledge and experience in the investment field as well as financial situation, including the ability to bear losses, and investment objectives of a typical customer of the target market.

13. When deciding whether a product is compatible with a target market, the manufacturer shall consider the level of information available to the target market and the financial literacy of the target market.
14. The target market shall be identified at a sufficiently granular level, depending on the characteristics, risk profile, complexity and nature of the product, avoiding groups of customers for whose demands and needs, and, where relevant, knowledge and experience in the investment field as well as financial situation and investment objectives, the product is generally not compatible.
15. Where relevant from a consumer protection perspective, the manufacturer shall also identify groups of customers for whom the product is generally not compatible.

Skills, knowledge and expertise of personnel involved in designing products

16. The manufacturer shall ensure that relevant personnel involved in designing products possess the necessary skills, knowledge and expertise in order to properly understand the product's main features and characteristics as well as the interests, objectives and characteristics of the target market.

Product testing

17. Before a product is brought to the market, or if the target market is changed, or changes to an existing product are introduced, the manufacturer shall conduct appropriate testing of the product including, if relevant, scenario analyses. The product testing shall assess if the product is in line with the objectives for the target market over the lifetime of the product.
18. The manufacturer shall not bring a product to the market if the results of the product testing show that the product is not aligned with the interests, objectives and characteristics of the target market.
19. The manufacturer shall carry out product testing in a qualitative and, where appropriate, in a quantifiable manner depending on the type and nature of the product and the related risk of detriment to customer.

Product monitoring and review

20. Once the product is distributed, the manufacturer shall continuously monitor and regularly review the product to identify crucial events that could materially affect the main features, the risk coverage and the guarantees of the products, e.g. the potential risk or return expectations.

21. When reviewing existing products, the manufacturer shall further consider if the product remains aligned with the demands and needs, and where relevant, with regard to the complexity of the product, the knowledge and experience in the investment field as well as the financial situation and investment objectives of the typical customer of the target market. The manufacturer shall also consider if the product is being distributed to the target market, or is reaching customers outside of the target market.

22. The manufacturer should determine the frequency for the regular review, taking into account the size, scale, contractual duration and complexity of the respective insurance product.

Remedial action

23. Should the manufacturer identify, during the lifetime of a product, circumstances which are related to the product and give rise to the risk of customer detriment, the manufacturer shall take appropriate action to mitigate the situation and prevent the re-occurrence of detriment.
24. If relevant, the manufacturer shall notify any relevant remedial action promptly to the distributors involved and to customers.

Distribution channels

25. The manufacturer shall select distribution channels that are appropriate for the target market considering the particular characteristics of the product.
26. The manufacturer shall select distributors with appropriate care.
27. The manufacturer shall provide to the insurance distributors all relevant information on the insurance product, the product approval process, the target market and distribution strategy.

    This includes information on the main characteristics of the insurance product, its risks and costs (including implicit costs), as well as circumstances which may cause a conflict of interest to the detriment of the customer. The information shall be of an adequate standard, which is clear, precise and up-to-date.
28. The information given to distributors shall be sufficient to enable them to:

- understand and place the product properly on the target market;
- identify the target market for which the product is designed and also to identify the group of customers for whom the product is considered likely not to meet their interests, objectives and characteristics; and
- to carry out insurance distribution activities in accordance with the best interests of its customers in accordance with Article 17(1) of Directive (EU) 2016/97.

29. The manufacturer shall take all reasonable steps to monitor that distribution channels act in compliance with the objectives of the manufacturer's product oversight and governance arrangements.
30. The manufacturer shall examine, on a regular basis, whether the product is distributed to customers belonging to the relevant target market.
31. When the manufacturer considers that the distribution channel does not meet the objectives of the manufacturer's product oversight and governance arrangements, the manufacturer shall take appropriate remedial action towards the distribution channel.

Outsourcing of the product design

32. The manufacturer shall retain full responsibility for compliance with product oversight and governance arrangements as described in this Technical Advice when it designates a third party to design products on their behalf.

Documentation of product oversight and governance arrangements

33. Relevant actions taken by the manufacturer in relation to the product oversight and governance arrangements shall be duly documented, kept for audit purposes and made available to the competent authorities upon request.

2. Policy proposals for insurance distributors which advise on or propose insurance products which they do not manufacture

Establishment of product distribution arrangements

34. The insurance distributor shall establish and implement product distribution arrangements that set out appropriate measures and procedures for considering the range of products and services the insurance distributor intends to offer to its customers, for reviewing the product distribution arrangements and for obtaining all necessary information on the product(s) from the manufacturer(s).

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

36. The insurance distributor shall set out the product distribution arrangements in a written document and make it available to its relevant staff.

Objectives of the product distribution arrangements

37. The product distribution arrangements shall aim to prevent or mitigate customer detriment, support a proper management of conflicts of interests and shall ensure that the customer's demands and needs, and, if relevant, their knowledge and experience in the investment field, their financial situation and investment objectives are duly taken into account.

Role of management

38. The insurance distributor's administrative, management or supervisory body or equivalent structure responsible for the insurance distribution, shall endorse and be ultimately responsible for the establishment, implementation, subsequent reviews and continued internal compliance with the product distribution arrangements.

Obtaining all relevant information on the insurance product from the manufacturer

39. The product distribution arrangements shall aim to ensure that the insurance distributor obtains all relevant information which have to be provided, as referred to in paragraph 27, from the manufacturer on the insurance product, the product approval process, the target market and the distribution strategy. This includes information on the main characteristics of the insurance product, its risks and costs (including implicit costs), as well as circumstances which may cause a conflict of interest to the detriment of the customer.

40. The information shall enable the distributors to:

- understand and place the product properly on the target market;
- identify the target market for which the product is designed and also to identify the group of customers for whom the product is considered likely not to meet their interests, objectives and characteristics; and

- to carry out insurance distribution activities in accordance with the best interests of the customer in accordance with Article 17(1) of Directive (EU) 2016/97.

Distribution strategy

41. Where the insurance distributor sets up or follows a distribution strategy, it shall not contradict the distribution strategy and the target market identified by the manufacturer of the insurance product.

Regular review of product distribution arrangements

42. The insurance distributor shall regularly review the product distribution arrangements to ensure that they are still valid and up to date and shall amend them where appropriate, in particular the distribution strategy, if any.
43. If the distributor has independently set up a distribution strategy, he shall amend the distribution strategy in view of the outcome of the review, where appropriate.
44. When reviewing distribution arrangements, the distributor shall consider if the product is being distributed to the identified target market, or is reaching customers outside the target market.
45. The distributor shall determine how regularly to review the product distribution arrangements based on relevant factors and taking into account the size, scale and complexity of the different products involved.
46. Upon request, distributors shall provide the manufacturer with relevant sales information and, if necessary, information on the above reviews to support product reviews carried out by manufacturers.

Informing the manufacturer

47. If the insurance distributor becomes aware of any problems causing the risk of customer detriment regarding the target market for a specific product or service, or that a given product or service no longer meets the criteria of the identified target market, he shall promptly inform the manufacturer and, as appropriate, update the distribution strategy already put in place.

Documentation

48. Relevant actions taken by the insurance distributor in relation to the product distribution arrangements shall be duly documented, kept for audit purposes and made available to the competent authorities on request.

4. Conflicts of Interest

Background/mandate

Extract from the Commission's request for advice (mandate)

"EIOPA is invited to provide technical advice on:

- *the different steps that insurance intermediaries and insurance undertakings distributing insurance-based investment products might reasonably be expected to take within an effective organisational and administrative arrangement designed to identify, prevent, manage and disclose conflicts of interest;*
- *the circumstances and situations to take into account when determining which types of conflict of interest may damage the interests of the customers or potential customers of an insurance intermediary or insurance undertaking.*

The technical advice should specify the different steps to be taken within an effective organisational and administrative arrangement designed to identify, prevent, manage and disclose conflicts of interest. This should include, in particular, the requirements for periodical review of conflicts of interest policies and clarifications with respect to the last resort nature of disclosure which should not be over-relied on by insurance intermediaries and insurance undertakings nor used as a measure to manage conflicts of interest. Particular attention should be given to the practical implementation of the proportionality requirement.

In order to ensure regulatory consistency, the technical advice should build on existing conflict of interest rules, as laid down in Commission Directive 2006/73/EC, particularly with regard to establishing appropriate criteria for determining the types of conflict of interest whose existence may damage the interests of customers or potential customers. It should also be consistent with the line taken in the delegated acts expected to be adopted under Article 23(4) of MiFID II."

1. The relevant provisions in the Insurance Distribution Directive are:

Recital 39:

"The expanding range of activities that many insurance intermediaries and undertakings carry on simultaneously has increased potential for conflicts of interest between those different activities and the interests of their customers. It is therefore necessary to provide for rules to ensure that such conflicts of interest do not adversely affect the interests of the customer".

Recital 57:

"In order to ensure that any fee or commission or any non-monetary benefit in connection with the distribution of an insurance-based investment product paid to or paid by any party, except the customer or a person on behalf of the customer, does not have a detrimental impact on the quality of the relevant service to the customer, the insurance distributor should put in place appropriate and proportionate arrangements in order to avoid such detrimental impact. To that end, the insurance

distributor should develop, adopt and regularly review policies and procedures relating to conflicts of interest with the aim of avoiding any detrimental impact on the quality of the relevant service to the customer and of ensuring that the customer is adequately informed about fees, commissions or benefits".

Article 27:

"Without prejudice to Article 17, an insurance intermediary or an insurance undertaking carrying on the distribution of insurance-based investment products shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest as determined under Article 28 from adversely affecting the interests of its customers. Those arrangements shall be proportionate to the activities performed, the insurance products sold and the type of the distributor."

Article 28:

1. *"Member States shall ensure that insurance intermediaries and insurance undertakings take all appropriate steps to identify conflicts of interest between themselves, including their managers and employees, or any person directly or indirectly linked to them by control, and their customers or between one customer and another, that arise in the course of carrying out any insurance distribution activities.*
2. *Where organisational or administrative arrangements made by the insurance intermediary or insurance undertaking in accordance with Article 27 to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to customer interests will be prevented, the insurance intermediary or insurance undertaking shall clearly disclose to the customer the general nature or sources of the conflicts of interest, in good time before the conclusion of an insurance contract.*

3. *By way of derogation from Article 23(1), the disclosure referred to in paragraph 2 of this Article shall:*

    (a) be made on a durable medium; and

    (b) include sufficient detail, taking into account the nature of the customer, to enable that customer to take an informed decision with respect to the insurance distribution activities in the context of which the conflict arises.

4. *The Commission shall be empowered to adopt delegated acts in accordance with Article 38 in order to:*

    (a) define the steps that insurance intermediaries and insurance undertakings might reasonably be expected to take to identify, prevent, manage and disclose conflicts of interest when carrying out insurance distribution activities;

    (b) establish appropriate criteria for determining the types of conflict of interest whose existence may damage the interests of the customers or potential customers of the insurance intermediary or insurance undertaking."

Analysis

2. EIOPA has been invited by the Commission to provide technical advice on organisational and administrative arrangements designed to identify, prevent, manage and disclose conflicts of interest that arise in the course of carrying out any insurance distribution activities.

3. In its mandate, the Commission explicitly invites EIOPA to build on the results of previous work that has already been carried out by EIOPA, such as EIOPA's previous technical advice on conflicts of interests in direct and intermediated sales of insurance-based investment products.[20] The latter was submitted to the Commission on 6 January 2015 and referred to the rules on conflicts of interest which were introduced under Article 91, MiFID II[21] and were supposed to amend the Insurance Mediation Directive (IMD)[22].

4. Taking into consideration that the new requirements on conflicts of interest as outlined in Articles 27 and 28, IDD, are almost identical with the requirements which have been originally introduced under MiFID II, EIOPA considers it appropriate to base its current technical advice on the previous policy recommendations. Some changes, in particular with regard to the disclosure of conflicts of interest, have been introduced for the sake of consistency with the wording of the IDD and for the purpose of alignment with the draft Commission Delegated Regulation under MiFID II regarding organisational requirements and operating conditions for investment firms[23].

5. For this purpose, it has been clarified that **the disclosure of conflict of interest should be understood as step of last resort to be used only in cases where the organisational and administrative measures are not sufficient to effectively prevent and manage conflicts of interest. Any overreliance on disclosure should be considered a deficiency in the conflicts of interest policy.**

6. Instances where conflicts of interest typically arise and which need to be appropriately managed by the insurance undertakings or insurance intermediary include the following:

   - The insurance undertaking/insurance intermediary has an own interest in selling products of its own group (e.g. funds contained in a unit linked product);
   - The insurance undertaking/insurance intermediary is receiving sales commissions and/or follow-up commissions;
   - There is a horizontal conflict of interest between different customers, because there is higher demand for a specific life product than occasion for concluding of contracts/supply;
   - The insurance undertaking/insurance intermediary is earning money in case of a change of funds during the lifetime of a unit-linked life insurance contract; or
   - The insurance undertaking/insurance intermediary can have an interest to recommend or not to recommend a certain insurance-based investment product due to his own portfolio (own-account trading).

[20] https://eiopa.europa.eu/Publications/Opinions/EIOPA-15-135_Technical%20Advice%20%20Impact%20Assessment_conflicts_of_interest_version%20for%20COM%20(2).pdf
[21] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0065
[22] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32002L0092
[23] http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2398-EN-F1-1.PDF

7. EIOPA acknowledges that the management of conflicts of interest, in particular those that arise between customers, should be undertaken in a way which takes into account the basic principles in insurance, in particular the principles of solidarity, risk pooling and mathematical methods.

8. EIOPA also notes that the European legislator has put emphasis on the application of the principle of proportionality in stating in Article 27, IDD, that the *"arrangements shall be proportionate to the activities performed, the insurance products sold and the type of distributor"*. EIOPA would like to point out that the policy proposals which were developed for the IMD explicitly refer to the principle of proportionality in stating that the procedures and measures should be *"appropriate to the size and activities of the insurance intermediaries or insurance undertaking … and to the materiality of the risk of damage to the interests of the customer".*

9. The measures and procedures taken by the insurance intermediary or insurance undertaking to identify, prevent and manage conflicts of interest under this section are without prejudice to the specific rules on inducements, in particular the obligation to assess the detrimental impact of inducements on the relevant service to the customer. EIOPA would like to emphasise that the assessment that a specific inducement or inducement scheme has a detrimental impact on the quality of the relevant service cannot be counterbalanced by any kind of organisational measure or procedure taken in accordance with the policy proposals outlined below.

Technical Advice

Identification of conflicts of interests

1. For the purpose of identifying the types of conflict of interest that arise in the course of carrying out any insurance distribution activities related to insurance-based investment products and which entail the risk of damage to the interests of a customer, insurance intermediaries and insurance undertakings shall assess whether they, including their managers, employees or any person directly or indirectly linked to them by control, have an interest related to the insurance distribution activities which is distinct from the customer's interest and which has the potential to influence the outcome of the services to the detriment of the customer. Insurance intermediaries and insurance undertakings shall also identify conflicts of interest between one customer and another.
2. For the purpose of identifying conflicts of interest as outlined in paragraph 1, insurance intermediaries and insurance undertakings shall take into account, by way of minimum criteria, any of the following situations:

a. the insurance intermediary, insurance undertaking, including their managers, employees, or any person directly or indirectly linked to them by control, is likely to make a financial gain, or avoid a financial loss, to the detriment of the customer;

b. the insurance intermediary, insurance undertaking, including their managers, employees, or any person directly or indirectly linked to them by control, has a financial or other incentive to favour the interest of another customer or group of customers over the interests of the customer;

c. the insurance intermediary, insurance undertaking, including their managers, employees, or any person directly or indirectly linked to them by control, receives or will receive from a person other than the customer a monetary or non-monetary benefit in relation to the insurance distribution activities provided to the customer;

d. the insurance intermediary, persons working in an insurance undertaking responsible for the distribution of insurance-based investment products or linked person, are substantially involved in the management or development of insurance based-investment products, in particular if they have an influence on the pricing of those products or its distribution costs.

Conflicts of interest policy

3. Insurance intermediaries and insurance undertakings shall establish, implement and maintain an effective conflicts of interest policy set out in writing and appropriate to their size and organisation and the nature, scale and complexity of their business. Where the insurance intermediary or insurance undertaking is a member of a group, the policy must also take into account any circumstances, of which the insurance intermediary or insurance undertaking is or should be aware, which may give rise to a conflict of interest arising as a result of the structure and business activities of other members of the group.

4. The conflicts of interest policy established in accordance with paragraph 3 shall include the following content:

(a) it must identify, with reference to the specific insurance distribution activities carried out, the circumstances which constitute or may give rise to a conflict of interest entailing a risk of damage to the interests of one or more customers;

(b) it must specify procedures to be followed and measures to be adopted in order to manage and prevent such conflicts from damaging the interests of the customer of the insurance intermediary or insurance undertaking, appropriate to the size and activities of the insurance intermediaries or insurance undertaking and of the group to which they belong, and to the risk of damage to the interests of the customer.

5. For the purpose of paragraph 4(b), the procedures to be followed and measures to be adopted shall include, where appropriate, in order to ensure that the distribution activities are carried out in accordance with the best interest of the customer and are not biased by conflicting interests of the insurance undertaking, the insurance intermediary or another customer, the following:

(a) effective procedures to prevent or control the exchange of information between relevant persons engaged in activities involving a risk of a conflict of interest where the exchange of that information may damage the interests of one or more customers;

(b) the separate supervision of relevant persons whose principal functions involve carrying out activities on behalf of, or providing services to, customers whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the insurance intermediary or insurance undertaking;

(c) 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;

(d) measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out insurance distribution activities;

(e) measures to prevent or control the simultaneous or sequential involvement of a relevant person in insurance distribution activities where such involvement may impair the proper management of conflicts of interest.

6. If insurance intermediaries and insurance undertakings demonstrate that those measures and procedures are not appropriate to ensure that the distribution activities are carried out in accordance with the best interest of the customer and are not biased by conflicting interests of the insurance undertakings, the insurance intermediaries or another customer, insurance intermediaries and insurance undertakings shall adopt adequate alternative measures and procedures for that purpose.

7. The measures and procedures taken by insurance intermediaries or insurance undertakings according to paragraph 4(b), shall be without prejudice to the specific rules on inducements, in particular the obligation to assess the detrimental impact of inducements on the relevant service to the customer.

8. Insurance intermediaries and insurance undertakings shall avoid over reliance on disclosure and shall ensure that disclosure, pursuant to Article 28(2) of

Directive (EU) 2016/97, is a step of last resort that can be used only where the effective organisational and administrative measures established by insurance intermediaries and insurance undertakings to prevent or manage conflicts of interests in accordance with Article 27 thereof are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests of the customer will be prevented.

9. Insurance intermediaries and insurance undertakings shall make that disclosure to customers, pursuant to Article 28(3) of Directive (EU) 2016/97/EC, in a durable medium. The disclosure shall:

(a) include a specific description of the conflict of interest, including the general nature and sources of the conflict of interest, as well as the risks to the customer that arise as a result of the conflict of interest and the steps undertaken to mitigate these risks,

(b) clearly state that the organisational and administrative arrangements established by the insurance intermediary or insurance undertaking are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests of the customer will be prevented, in order to enable the customer to take an informed decision with respect to the insurance distribution activities in the context of which the conflict of interest arises.

10. Insurance intermediaries and insurance undertakings shall:

(a) assess and periodically review – at least annually – the conflicts of interest policy established in accordance with this article and to take all appropriate measures to address any deficiencies, and

(b) keep and regularly update a record of the situations in which a conflict of interest entailing a risk of damage to the interests of the one or more customers has arisen or, in the case of an ongoing service or activity, may arise.

11. Where established, senior management of the insurance intermediary or insurance undertaking shall receive on a frequent basis, and at least annually, written reports on these situations.

5. Inducements

Background/mandate

Extract from the Commission's request for advice (mandate)

"EIOPA is invited to provide technical advice on:

- *the conditions under which payments and non-monetary benefits paid or received by insurance intermediaries or insurance undertakings in connection with the distribution of an insurance-based investment product may have a detrimental impact on the quality of the relevant service to the customer;*

- *the circumstances and situations to take into account when determining whether an insurance distributor or an insurance undertaking paying or receiving inducements complies with its obligation to act honestly, fairly and professionally in accordance with the best interests of the customer.*

The technical advice should specify the methodology to be applied in determining a possible detrimental impact of inducements on the quality of the service and testing compliance with the insurance intermediaries' and insurance undertakings' duty to act in the best interests of its customers. Further clarification should be given with respect to the factual and legal elements and circumstances to take into account in determining whether the conditions set in Article 29(2) are met.

To achieve greater convergence in the application of the detrimental impact criteria, the technical advice should indicate examples of circumstances where a fee, commission or non-monetary benefit may generally be regarded as having a detrimental effect on the quality of the relevant service to the customer. This could be complemented by an exemplary enumeration of circumstances where third-party payments and benefits are generally considered acceptable. In the same way, it should identify circumstances indicating that an insurance intermediary or an insurance undertaking does not comply with the obligation to act honestly, fairly and in accordance with the best interests of the customer.

The technical advice should be consistent with the line taken in the delegated acts expected to be adopted under Article 24(13) of MiFID II, while recognising the difference in terminology between Article 29(2) (a) of the Directive and Article 24(9)(a) of MiFID II".

1. The relevant provisions in the Insurance Distribution Directive are:

Recital 57:

"In order to ensure that any fee or commission or any non-monetary benefit in connection with the distribution of an insurance-based investment product paid to or paid by any party, except the customer or a person on behalf of the customer, does not have a detrimental impact on the quality of the relevant service to the customer, the insurance distributor should put in place appropriate and proportionate arrangements in order to avoid such detrimental impact. To that end, the insurance distributor should develop, adopt and regularly review policies and procedures relating to conflicts of interest with the aim of avoiding any detrimental impact on the quality of the relevant service to the customer and of ensuring that the customer is adequately informed about fees, commissions or benefits".

Article 29(2):

"Without prejudice to points (d) and (e) of Article 19(1) and Article 22(3), Member States shall ensure that insurance intermediaries or insurance undertakings are regarded as fulfilling their obligations under Article 17(1), Article 27 or Article 28 where they pay or are paid any fee or commission, or provide or are provided with any non-monetary benefit in connection with the distribution of an insurance-based investment product or an ancillary service, to or by any party except the customer or a person on behalf of the customer only where the payment or benefit:

(a) does not have a detrimental impact on the quality of the relevant service to the customer; and
(b) does not impair compliance with the insurance intermediary's or insurance undertaking's duty to act honestly, fairly and professionally in accordance with the best interests of its customers."

Article 29(4):

"Without prejudice to paragraph 3 of this Article, the Commission shall be empowered to adopt delegated acts in accordance with Article 38 to specify:

(a) the criteria for assessing whether inducements paid or receive by an insurance intermediary or an insurance undertaking have a detrimental impact on the quality of the relevant service to the customer;
(b) the criteria for assessing compliance of insurance intermediaries and insurance undertakings paying or receiving inducements with the obligation to act honestly, fairly and professionally in accordance with the best interests of the customer."

Analysis

2. The Commission's request for advice refers to the "*payments and non-monetary benefits paid or received by insurance intermediaries or insurance undertakings in connections with the distribution of an insurance-based investment product*".

3. Although IDD does not entail an explicit definition of an "inducement", Article 29(2), IDD clarifies that it refers to the payment of any fee or commission as well as the provision of any non-monetary benefit in connection with the distribution of an insurance-based investment product or an ancillary service, to or by any third party except the customer or a person on behalf of the customer. Unlike Article 17(3), IDD, Article 29(2) does not comprise internal payments from insurance distributors to their employees. In addition, the Commission's mandate makes explicit reference to "third party payments and benefits".

4. Therefore, **EIOPA's conclusion is that the Commission is seeking advice in relation to fees or commissions as well as non-monetary benefits paid by or to <u>third parties only</u>, but not in relation to internal payments (e.g. fees paid by the customer or internal payments to employees of insurance distributors).**

5. EIOPA would like to emphasise that EIOPA has an impartial view on the business models of insurance distributors and does not advocate for the establishment of a fee-based distribution model against a commission-based distribution model. At the same time, EIOPA acknowledges that conflicts of interest may arise in both instances which oblige the entities concerned to take appropriate measures to manage these conflicts of interest in order to avoid any damage to customers.

6. EIOPA understands the term, "inducement", as any fee, commission, any other monetary or non-monetary benefit which is paid or provided in connection with the distribution of an insurance-based investment product or an ancillary service to or by any party except the customer or a person on behalf of the customer.

7. Moreover, EIOPA understands the term "inducement scheme" to mean a set of rules that govern the payment of inducements and which generally includes a description of the respective obligations of the person paying the inducements and the person receiving the inducements. It normally outlines the criteria which the recipient of the inducements must achieve in order to earn an inducement and specifies the obligations to pay the inducements. It might elaborate on the amount of the inducement or how the inducement is calculated and any other governance measures in relation to the payment of the inducement. For example, an inducement scheme can be included as part of a contract of appointment between a distributor and a manufacturer.

8. The IDD requires insurance intermediaries and insurance undertakings to apply the general rules laid down in Articles 27 and 28 of the IDD for the identification and the specific requirements on inducements as laid down in Article 29(2) IDD (two step approach):

   a. In a *first* step, insurance undertakings and insurance intermediaries have to identify all inducements which are paid in connection with the distribution of insurance products.

   b. In a *second* step, insurance undertakings and insurance intermediaries have to establish adequate procedures to assess whether the inducements have a detrimental impact and of specific organisational measures as outlined below aiming to address the risks of customer detriment caused by the payment of inducements.

9. EIOPA would like to emphasise that the assessment that a specific inducement or inducement scheme has a detrimental impact on the quality of the relevant service, cannot be counterbalanced by any kind of organisational measure or procedure taken in accordance with the general rules on the management of conflict of interest as outlined above.

10. Furthermore, EIOPA would like to emphasise that the disclosure of inducements is specifically addressed by Article 29(1)(c)[24] and the second subparagraph of Article 29(1), IDD, as well as Article 19, IDD which entails more general and simple pre-contractual status disclosure which generally precede the general rules on the disclosure of conflicts of interest (see the policy proposals above), including the disclosure as a step of last resort.

11. The Commission has asked EIOPA to provide technical advice on the conditions under which inducements may have a detrimental impact on the quality of the relevant service to the customer.

12. Although EIOPA has been asked by the Commission to ensure "*as much regulatory consistency as possible in the conduct of business standards for IBIPs and financial instruments under MiFID II*", EIOPA notes that the IDD uses different terminology than the respective rules introduced by MiFID II which form the basis of ESMA's technical advice for MiFID II.

13. Whereas MiFID II requires that the inducement "*is designed to enhance the quality of the relevant service to the client*"[25], the IDD requires that the inducement does "*not have a detrimental impact on the quality of the relevant service to the customer*"[26]. From EIOPA's point of view, it is important to adequately consider these differences, which have been agreed upon by the European legislators, when establishing implementing measures for specifying the conditions under which inducements have a detrimental impact on the quality of the services.

14. In view of the cross-sectoral implications, EIOPA believes, however, that the approach for IDD should offer as much compatibility as possible to avoid any unnecessary burden for market participants and to further pursue the goal of a level playing field across the different financial sectors.

15. Against this background, EIOPA proposes to introduce a methodology which is based upon a high-level principle stating the circumstances under which an inducement might have a "*detrimental impact on the relevant service to the customer*". This high-level principle is complemented by a non-exhaustive list of criteria to be considered when assessing whether inducements increase the risk of detrimental impact on the quality of the relevant service to the customer. For the sake of consistency, the high level principle mirrors the general requirement in Article 17(1) of the IDD requiring that "*insurance distributors always act honestly, fairly and professionally in accordance with the best interests of their customers*" when carrying out insurance distribution.

16. According to the methodology proposed by EIOPA, insurance undertakings and insurance intermediaries are required to consider whether one or more of the listed instances increases the risk of detrimental impact on the quality of service. Even if this is the case, this need not automatically lead to the conclusion that the inducement or inducement scheme is detrimental on the quality of the relevant service to the customer. This decision ultimately depends on an overall analysis which should take into consideration all relevant factors which may

[24] See the reference to "also encompassing any third party payments".
[25] Article 24(9)(a), MiFID II
[26] Article 29(2)(a), IDD

increase and decrease the risk of detrimental impact, as well as all organisational measures taken by the insurance undertaking or insurance intermediary aiming to ensure that the inducements do not provide any incentive to carry out the insurance distribution activities in a way which is not in accordance with the best interest of the customer (a "holistic assessment").

17. If none of the listed instances arise in a given situation, the high-level principle still applies. In this case, the focus of the assessment lies on the question whether the inducement or inducement scheme encourage the insurance undertaking or insurance intermediary to carry out distribution activities in a way which is not in accordance with the best interests of the customer. The latter depends on factors such as the respective type, size, design and structure of the inducement or inducement scheme. Here again, the assessment should be based on a holistic assessment which also takes into consideration organisational measures as referred to above.

18. For the sake of clarification, EIOPA would like to point out that, generally speaking, inducements which have a detrimental impact on the quality of the relevant service to the customer, also impair compliance with the insurance intermediary's or insurance undertaking's duty to act honestly, fairly and professionally in accordance with the best interests of its customers (Article 29 (2)(b) IDD). **For this reason, although the Commission's mandate mentions these two aspects separately, they have been analysed together for the purposes of this technical advice.**

19. As outlined, EIOPA proposes to supplement the aforementioned high-level principle with a list of criteria to comply with the Commission's request for EIOPA to list *"examples of circumstances where a fee, commission or non-monetary benefit may generally be regarded as having a detrimental effect on the quality of the relevant service to the customer"*.

20. EIOPA would like to clarify, however, that **this list is not supposed to introduce a legal assumption of detrimental impact, but to specify criteria to be considered when assessing whether an inducement or inducement scheme increases the "risk" of exposure to a detrimental impact on the quality of the relevant service to the customer**. EIOPA acknowledges that commission-based distribution is still a widespread practice in some Member States and that commissions are a percentage of the premium paid by the customer for coverage based upon the intermediary's agreement with the insurance undertaking which are, in principle, meant to compensate for services linked to the conclusion of the contract or services provided during the lifetime of the insurance contract. **Therefore, EIOPA would like to emphasise that the objective of this list is <u>not</u> to introduce a** *de facto* **prohibition on the receipt/payment of inducements, <u>but</u> to provide guidance to market participants in assessing inducements and to point out specific circumstances where there is an increased risk of a detrimental impact. The list builds upon supervisory work of national competent authorities**[27]

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[27] For example:

- The NL AFM reported in 2011 about **excessive commissions in the context of the distribution of payment protection insurance (PPI) products** where commissions of up to 86% of the single insurance premium were paid. It was also reported about the successful introduction of national legislation to eliminate "hit and run" practices which are initiated by revenue-related boni. Although referring to non-IBIPs products, this example shows the practical relevance of this issue: https://www.rijksoverheid.nl/documenten/kamerstukken/2009/06/16/bijlage-provisies-voor-bemiddelaars-in-krediet-beschermers

and entails payments such as contingent commissions[28], profit commissions, upfront commissions and excessive sales targets.

21. With regard to the request from the Commission to provide *"an exemplary enumeration of circumstances where third-party payments and benefits are generally considered acceptable*", EIOPA would like to emphasise that a "positive list" outlining circumstances generally considered acceptable, entails the high risk of creating loopholes for regulatory arbitrage and might restrict the ability of national competent authorities to take prohibitive action in relation to inducements both *ex ante* and *ex post*. In addition, there is the risk that such a list can become outdated and does not reflect current market and technological developments. It could be very challenging for a supervisory authority to "future-proof" a white list or construct it in such a way so as to ensure that insurance undertakings or insurance intermediaries do not misinterpret it more widely than is intended and in such a way as to circumvent the inducement rules. By way of an example, one national competent authority's supervisory experience was that similar safe harbour provisions in their national law, foiled the achievement of the legislative purpose of strengthening the protection of customers[29].

- UK FCA guidance on inducements published in January 2014 also provides a steer (https://www.fca.org.uk/static/documents/finalised-guidance/fg14-01.pdf). For example, paragraph 2.25 identifies examples of poor practice in relation to payments by providers for development by intermediaries of IT facilities. Similarly, paragraph 2.31 identifies generic examples of poor practices linked to **excessive payments by life insurers to advisory firms to attend their seminars and conferences**. Also para 2.36 refers to amounts of **"unreasonable value" when providing gifts/prizes and hospitality**.

- In order to create a sounder market for advice on financial products, the Swedish Finansinspektionen (FI) has proposed **a ban on commissions in connection with investment advice and mediation of life insurance with elements of saving.** FI has specifically highlighted the problems with commissions paid out directly in connection with signing up for products or entering insurance agreements, known as **up-front commissions**. In 2014, the FI conducted a survey of commission income on the advisory market, covering around 200 insurance intermediaries, and firms authorised to conduct securities business. The survey showed that "among both insurance intermediaries *and investment firms, it is very common to have commissions that are paid out in direct connection with the customer purchasing the product,* known as upfront commissions"….."Upfront commissions are particularly problematic because they also incentivise firms to recommend that consumers frequently switch investments*, with the sole purpose of generating fresh commission income for the firm*": http://www.fi.se/upload/90_English/20_Publications/10_Reports/2015/konsumentrapp_2015engNY.pdf

- In **EIOPA's Third Annual Consumer Trends Report**, it was reported that DE, IE and NO carried out supervisory reviews of selling practices in response to mis-selling cases which found, for example, that sales incentive schemes might have components (**such as the use of thresholds/targets to unlock incentives,** 100% variable remuneration), which encouraged poor sales behaviour. The incentive schemes did not place sufficient emphasis on linking fair treatment of customers (or deterring/penalising poor treatment of customers) with the receipt of incentives: https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-207-Third_Consumer_Trends_Report.pdf

- In **EIOPA's Fourth Annual Consumer Trends Report**, it was reported that *"some NCAs also reviewed possible conflicts of interest arising from the selection of the underlying funds. If adequate governance and control frameworks are not in place, there is a risk that investments are made on the basis of those which provide the* highest commission from fund managers *and not in the best interests of the consumer":* https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-15-233%20-%20EIOPA_Fourth_Consumer_Trends_Report.pdf

[28] Contingent commissions and profit commissions were also identified by the Commission, as sources of conflict of interest, in the context of its Sector Inquiry on business insurance in 2007 (notwithstanding that this inquiry was primarily focussed on non-life products in the non-retail sector): *"Conflicts of interest that could jeopardise the role of brokers and multiple agents in stimulating competition in the insurance marketplace can also arise from a number of sources, linked to their remuneration, including contingent commissions and fees from services rendered to insurers".* http://ec.europa.eu/competition/sectors/financial_services/inquiries/final_report_annex.pdf

[29] In the UK FCA's Inducement rules, it was recognised that some payments or benefits offered by providers to advisory firms can be in the customer's best interests, and the conflicts of interest arising can be managed. Two thematic projects by the FCA following the introduction of the Retail Distribution Review (RDR) showed how some firms took an overly broad interpretation of this to justify a wide range of benefits that in the FCA's view, did not meet the inducements rules. In the end, the FCA was obliged to issue further guidance to dispel any ambiguity around the interpretation of the white list: https://www.fca.org.uk/publications/finalised-guidance/fg14-1-supervising-retail-investment-advice-inducements-and

22. Therefore, EIOPA recommends not including such a positive list in the technical advice. However, EIOPA acknowledges that specific circumstances may be considered to decrease the risk of detrimental impact on the quality of the relevant service to the customer and could be taken into consideration as part of an overall assessment.

23. Without prejudice to additional requirements of IDD applicable to insurance distribution, in particular Article 30 IDD, the possibility of Member States to impose stricter requirements as stated in Article 29(3), IDD and the outcome of a thorough overall analysis of all relevant circumstances, the following practices may be considered to decrease the risk that inducements have a detrimental impact on the quality of the service to the customer, if they are appropriately taken into account:

   - The inducement scheme allows the insurance undertaking to claim back any inducement in cases where the interests of a customer have been harmed while carrying out insurance distribution activities to the customer;
   - The inducement scheme provides for the prompt refunding of any inducements if the product lapses or is surrendered at an early stage; or
   - The inducement is solely or predominantly based on qualitative criteria, reflecting compliance with the applicable regulations, fair treatment and satisfaction of customers and the quality of services provided to customers on a continuous basis.

24. This list is non-exhaustive and is not intended to create a legal "safe harbour" and should be understood as examples of criteria to be applied in an overall analysis, only. They are deemed to promote more customer-centric behaviour by distributors. **It should be noted that insurance undertakings and insurance intermediaries are, in any case, not relieved from a thorough assessment whether an inducement has a detrimental impact and that these practices may not be adequate or sufficient to mitigate the risk of detrimental impact in an appropriate way, depending on the specific circumstances of the individual case.**

25. Furthermore, EIOPA considers it important that specific organisational measures are introduced to support and ensure that the substantive requirements are fulfilled by regulated entities on an ongoing basis. EIOPA considers that the responsibility and the types of organisational measures will be different for those who pay inducements and those who receive them.

26. Insurance undertakings and insurance intermediaries who pay inducements should have organisational measures in place to assess the design and structure of any inducement scheme which they pay to insurance distributors to ensure it is compliant with Article 29(2). In this context, EIOPA would like to emphasise that insurance undertakings and insurance intermediaries are not required to assess any individual inducement which is paid following the sale of an insurance contract to a particular customer, but only to assess the generic inducement which is paid for selling a particular type of product.

27. Insurance intermediaries and insurance undertakings who receive inducements need to consider the inducement schemes which they are party to, both individually and collectively, and ensure that there are organisational measures in place to ensure that inducements do not lead to detriment for customers and

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https://www.fca.org.uk/publications/guidance-consultations/gc13-5-supervising-retail-investment-advice-inducements-and

do not hinder their ability to act honestly, fairly and in accordance with the best interests of their customers.

Technical Advice

Inducement and Inducement Scheme

1. An inducement is any fee, commission, or any other monetary or non-monetary benefit which is paid or provided in connection with the distribution of an insurance-based investment product or an ancillary service to or by any party except the customer or a person on behalf of the customer.

2. An inducement scheme is a set of rules that govern the payment of inducements. It generally includes the criteria under which inducements are paid.

Methodology and criteria for assessing the detrimental impact

3. An inducement or inducement scheme has a detrimental impact on the quality of the relevant service to the customer if it is of such a nature and scale that it provides an incentive to carry out insurance distribution activities in a way which is not in accordance with the best interests of the customer.

4. Insurance undertakings and insurance intermediaries shall assess all relevant factors which increase or decrease the risk of detrimental impact on the quality of the relevant service to the customer.

5. Insurance undertakings and insurance intermediaries shall, in particular, take into consideration the following criteria in order to assess whether inducements or inducement schemes increase the risk of detrimental impact:

a) the inducement or inducement scheme encourages the insurance intermediary or insurance undertaking carrying out distribution activities to offer or recommend a product or service to a customer when the insurance intermediary or insurance undertaking could, from the outset, propose a different available product or service which would better meet the customer's needs;

b) the inducement or inducement scheme is solely or predominantly based on quantitative commercial criteria and does not take into account appropriate qualitative criteria, reflecting compliance with the applicable regulations, fair treatment of customers and the quality of services provided to customers;

c) the value of the inducement is disproportionate when considered against the value of the product and the services provided in relation to the product;

d) the inducement is entirely or mainly paid upfront when the product is sold without any appropriate refunding mechanism if the product lapses or is surrendered at an early stage;

e) the inducement scheme does not provide for an appropriate refunding mechanism if the product lapses or is surrendered at an early stage;

f) if the inducement scheme entails any form of variable or contingent threshold or any other kind of value accelerator which is unlocked by attaining a sales target based on volume or value of sales.

6. The list of criteria as laid down in paragraph 5 is non-exhaustive.

Organisational requirements

7. Insurance undertakings and insurance intermediaries shall establish, implement and maintain appropriate organisational arrangements and procedures in order to assess on an ongoing basis and ensure that the generic inducement paid for a particular type of contract and the structure of inducement schemes which they pay to or receive:

a. do not lead to a detrimental impact on the quality of the service provided to customers; and

b. do not prevent the insurance intermediary or insurance undertaking from complying with their obligation to act honestly, fairly and professionally and in accordance with the best interests of their customers.

8. The assessment shall be based upon an overall analysis which takes into consideration:

a) all relevant factors which may increase or decrease the risk of detrimental impact; and

b) appropriate organisational measures taken by the insurance undertaking or insurance intermediary to decrease the risk of detrimental impact, which aim to ensure that the inducements do not provide any incentive to carry out the insurance distribution activities in a way which is not in accordance with the best interests of the customer.

9. Insurance undertakings and insurance intermediaries as referred to in paragraph 7 shall ensure that any inducement scheme is approved by the insurance undertaking or insurance intermediary's senior management.

10. Insurance intermediaries and insurance undertakings shall document the assessment referred to in paragraph 8 in a durable medium.

11. As part of the conflicts of interest policy *[as outlined under Section 5 of this technical advice]*, insurance intermediaries and insurance undertakings shall set up a gifts and benefits policy that stipulates what gifts and benefits are acceptable and what should happen where limits are breached.

6. Assessment of suitability and appropriateness and reporting to customers

Extract from the Commission's request for advice (mandate)

"EIOPA is invited to provide technical advice on the information to obtain when assessing the suitability or appropriateness of insurance-based investment products for their customers, whereby a distinction has to be made between the situation when advice is provided and the situation when no advice is provided".

"EIOPA is invited to provide technical advice on the content and format of records and agreements for the provision of services to customers".

"EIOPA is invited to provide technical advice on the content and format of periodic reports to customers on the services provided."

1. The following provisions in the Insurance Distribution Directive are relevant to this topic:

Recital 10:

Current and recent financial turbulence has underlined the importance of ensuring effective consumer protection across all financial sectors. It is appropriate, therefore, to strengthen the confidence of customers and to make regulatory treatment of the distribution of insurance products more uniform in order to ensure an adequate level of customer protection across the Union. The level of consumer protection should be raised in relation to Directive 2002/92/EC in order to reduce the need for varying national measures. It is important to take into consideration the specific nature of insurance contracts in comparison to investment products regulated under Directive 2014/65/EU of the European Parliament and of the Council (1). The distribution of insurance contracts, including insurance-based investment products, should therefore be regulated under this Directive and be aligned with Directive 2014/65/EU. The minimum standards should be raised with regard to distribution rules and a level playing field should be created in respect of all insurance-based investment products.

Recital 56:

Insurance-based investment products are often made available to customers as potential alternatives or substitutes to investment products subject to Directive 2014/65/EU. To deliver consistent investor protection and avoid the risk of regulatory arbitrage, it is important that insurance-based investment products are subject, in addition to the conduct of business standards defined for all insurance products, to specific standards aimed at addressing the investment element embedded in those products. Such specific standards should include provision of appropriate information and requirements for advice to be suitable...

Article 2(1)(18):

'durable medium' means any instrument which:

(a) enables a customer to store information addressed personally to that customer in a way accessible for future reference and for a period of time adequate for the purposes of the information; and

(b) allows the unchanged reproduction of the information stored.

Article 20(1):

Prior to the conclusion of an insurance contract, the insurance distributor shall specify, on the basis of information obtained from the customer, the demands and the needs of that customer and shall provide the customer with objective information about the insurance product in a comprehensible form to allow that customer to make an informed decision.

Any contract proposed shall be consistent with the customer's insurance demands and needs.

Where advice is provided prior to the conclusion of any specific contract, the insurance distributor shall provide the customer with a personalised recommendation explaining why a particular product would best meet the customer's demands and needs.

Article 23(1):

All information to be provided in accordance with Articles 18, 19, 20 and 29 shall be communicated to the customer:
(a) on paper;
(b) in a clear and accurate manner, comprehensible to the customer;
(c)in an official language of the Member State in which the risk is situated or of the Member State of the commitment or in any other language agreed upon by the parties; and
(d) free of charge.

Article 29(1):

1. Without prejudice to Article 18 and Article 19(1) and (2), appropriate information shall be provided in good time, prior to the conclusion of a contract, to customers or potential customers with regard to the distribution of insurance-based investment products, and with regard to all costs and related charges. That information shall include at least the following:

(a) when advice is provided, whether the insurance intermediary or insurance undertaking will provide the customer with a periodic assessment of the suitability of the insurance-based investment products recommended to that customer, referred to in Article 30.

Article 30(1):

Without prejudice to Article 20(1), when providing advice on an insurance-based investment product, the insurance intermediary or insurance undertaking shall also obtain the necessary information regarding the customer's or potential customer's knowledge and experience in the investment field relevant to the specific type of product or service, that person's financial situation including that person's ability to bear losses, and that person's investment objectives, including that person's risk tolerance, so as to enable the insurance intermediary or the insurance undertaking to recommend to the customer or potential customer the insurance-based investment products that are suitable for that person and that, in particular, are in accordance with that person's risk tolerance and ability to bear losses.

Member States shall ensure that where an insurance intermediary or insurance undertaking provides investment advice recommending a package of services or products bundled pursuant to Article 24, the overall bundled package is suitable.

Article 30(2):

Without prejudice to Article 20(1), Member States shall ensure that an insurance intermediary or insurance undertaking, when carrying out insurance distribution activities other than those referred to in paragraph 1 of this Article, in relation to sales where no advice is given, asks the customer or potential customer to provide information regarding that person's knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the insurance intermediary or the insurance undertaking to assess whether the insurance service or product envisaged is appropriate for the customer. Where a bundle of services or products is envisaged pursuant to Article 24, the assessment shall consider whether the overall bundled package is appropriate.

Where the insurance intermediary or insurance undertaking considers, on the basis of the information received under the first subparagraph, that the product is not appropriate for the customer or potential customer, the insurance intermediary or insurance undertaking shall warn the customer or potential customer to that effect. That warning may be provided in a standardised format.

Where customers or potential customers do not provide the information referred to in the first subparagraph, or where they provide insufficient information regarding their knowledge and experience, the insurance intermediary or insurance undertaking shall warn them that it is not in a position to determine whether the product envisaged is appropriate for them. That warning may be provided in a standardised format.

Article 30(4):

The insurance intermediary or insurance undertaking shall establish a record that includes the document or documents agreed between the insurance intermediary or insurance undertaking and the customer that set out the rights and obligations of the parties, and the other terms on which the insurance intermediary or insurance undertaking will provide services to the customer. The rights and duties of the parties to the contract may be incorporated by reference to other documents or legal texts.

Article 30(5):

The insurance intermediary or insurance undertaking shall provide the customer with adequate reports on the service provided on a durable medium. Those reports shall include periodic communications to customers, taking into account the type and the complexity of insurance-based investment products involved and the nature of the service provided to the customer and shall include, where applicable, the costs associated with the transactions and services undertaken on behalf of the customer.
When providing advice on an insurance-based investment product, the insurance intermediary or the insurance undertaking shall, prior to the conclusion of the contract, provide the customer with a suitability statement on a durable medium specifying the advice given and how that advice meets the preferences, objectives and other characteristics of the customer. The conditions set out in Article 23(1) to (4) shall apply.
Where the contract is concluded using a means of distance communication which prevents the prior delivery of the suitability statement, the insurance intermediary or

the insurance undertaking may provide the suitability statement on a durable medium immediately after the customer is bound by any contract, provided both of the following conditions are met:

(a) the customer has consented to receiving the suitability statement without undue delay after the conclusion of the contract; and
(b) the insurance intermediary or insurance undertaking has given the customer the option of delaying the conclusion of the contract in order to receive the suitability statement in advance of such conclusion.

Where an insurance intermediary or an insurance undertaking has informed the customer that it will carry out a periodic assessment of suitability, the periodic report shall contain an updated statement of how the insurance-based investment product meets the customer's preferences, objectives and other characteristics of the customer.

Article 30(6):

The Commission shall be empowered to adopt delegated acts in accordance with Article 38 to further specify how insurance intermediaries and insurance undertakings are to comply with the principles set out in this Article when carrying out insurance distribution activities with their customers, including with regard to the information to be obtained when assessing the suitability and appropriateness of insurance-based investment products for their customers…….. Those delegated acts shall take into account:

(a) the nature of the services offered or provided to the customer or potential customer, taking into account the type, object, size and frequency of the transactions;
(b) the nature of the products being offered or considered including different types of insurance-based investment products;
(c) the retail or professional nature of the customer or potential customer.

2. The following provisions in Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU ("MiFID II") are relevant to this topic:

Article 25(2)(3):

2. When providing investment advice or portfolio management the investment firm shall obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, that person's financial situation including his ability to bear losses, and his investment objectives including his risk tolerance so as to enable the investment firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him and, in particular, are in accordance with his risk tolerance and ability to bear losses.

Member States shall ensure that where an investment firm provides investment advice recommending a package of services or products bundled pursuant to Article 24(11), the overall bundled package is suitable.

3. Member States shall ensure that investment firms, when providing investment services other than those referred to in paragraph 2, ask the client or potential client to provide information regarding that person's knowledge and experience in the

investment field relevant to the specific type of product or service offered or demanded so as to enable the investment firm to assess whether the investment service or product envisaged is appropriate for the client. Where a bundle of services or products is envisaged pursuant to Article 24(11), the assessment shall consider whether the overall bundled package is appropriate.

Where the investment firm considers, on the basis of the information received under the first subparagraph, that the product or service is not appropriate to the client or potential client, the investment firm shall warn the client or potential client. That warning may be provided in a standardized format.

Where clients or potential clients do not provide the information referred to under the first subparagraph, or where they provide insufficient information regarding their knowledge and experience, the investment firm shall warn them that the investment firm is not in a position to determine whether the service or product envisaged is appropriate for them. That warning may be provided in a standardized format.

3. The following provisions in the draft Commission Delegated Regulation under MiFID II are relevant for this topic:

Article 54 - Assessment of suitability and suitability reports (Article 25(2) of Directive 2014/65/EU):

1. Investment firms shall not create any ambiguity or confusion about their responsibilities in the process when assessing the suitability of investment services or financial instruments in accordance with Article 25(2) of Directive 2014/65/EU. When undertaking the suitability assessment, the firm shall inform clients or potential clients, clearly and simply, that the reason for assessing suitability is to enable the firm to act in the client's best interest.

Where investment advice or portfolio management services are provided in whole or in part through an automated or semi-automated system, the responsibility to undertake the suitability assessment shall lie with the investment firm providing the service and shall not be reduced by the use of an electronic system in making the personal recommendation or decision to trade.

2. Investment firms shall determine the extent of the information to be collected from clients in light of all the features of the investment advice or portfolio management services to be provided to those clients. Investment firms shall obtain from clients or potential clients such information as is necessary for the firm to understand the essential facts about the client and to have a reasonable basis for determining, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of providing a portfolio management service, satisfies the following criteria:

(a) it meets the investment objectives of the client in question, including client's risk tolerance;
(b) it is such that the client is able financially to bear any related investment risks consistent with his investment objectives;
(c) it is such that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.
3. Where an investment firm provides an investment service to a professional client it shall be entitled to assume that in relation to the products, transactions and services

for which it is so classified, the client has the necessary level of experience and knowledge for the purposes of point (c) of paragraph 2.

Where that investment service consists in the provision of investment advice to a professional client covered by Section 1 of Annex II to Directive 2014/65/EU, the investment firm shall be entitled to assume for the purposes of point (b) of paragraph 2 that the client is able financially to bear any related investment risks consistent with the investment objectives of that client.

4. The information regarding the financial situation of the client or potential client shall include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments.

5. The information regarding the investment objectives of the client or potential client shall include, where relevant, information on the length of time for which the client wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.

6. Where a client is a legal person or a group of two or more natural persons or where one or more natural persons are represented by another natural person, the investment firm shall establish and implement policy as to who should be subject to the suitability assessment and how this assessment will be done in practice, including from whom information about knowledge and experience, financial situation and investment objectives should be collected. The investment firm shall record this policy.

Where a natural person is represented by another natural person or where a legal person having requested treatment as professional client in accordance with Section 2 of Annex II of Directive 2014/65/EU is to be considered for the suitability assessment, the financial situation and investment objectives shall be those of the legal person or, in relation to the natural person, the underlying client rather than of the representative. The knowledge and experience shall be that of the representative of the natural person or the person authorised to carry out transactions on behalf of the underlying client.

7. Investment firms shall take reasonable steps to ensure that the information collected about their clients or potential clients is reliable. This shall include, but shall not be limited to, the following:

(a) ensuring clients are aware of the importance of providing accurate and up-to-date information;
(b) ensuring all tools, such as risk assessment profiling tools or tools to assess a client's knowledge and experience, employed in the suitability assessment process are fit-for-purpose and are appropriately designed for use with their clients, with any limitations identified and actively mitigated through the suitability assessment process;
(c) ensuring questions used in the process are likely to be understood by clients, capture an accurate reflection of the client's objectives and needs, and the information necessary to undertake the suitability assessment; and
(d) taking steps, as appropriate, to ensure the consistency of client information, such as by considering whether there are obvious inaccuracies in the information provided by clients.

Investment firms having an on-going relationship with the client, such as by providing an ongoing advice or portfolio management service, shall have, and be able to demonstrate, appropriate policies and procedures to maintain adequate and up-to-date information about clients to the extent necessary to fulfil the requirements under paragraph 2.

8. Where, when providing the investment service of investment advice or portfolio management, an investment firm does not obtain the information required under Article 25(2) of Directive 2014/65/EU, the firm shall not recommend investment services or financial instruments to the client or potential client.

9. Investment firms shall have, and be able to demonstrate, adequate policies and procedures in place to ensure that they understand the nature, features, including costs and risks of investment services and financial instruments selected for their clients and that they assess, while taking into account cost and complexity, whether equivalent investment services or financial instruments can meet their client's profile.

10. When providing the investment service of investment advice or portfolio management, an investment firm shall not recommend or decide to trade where none of the services or instruments are suitable for the client.

11. When providing investment advice or portfolio management services that involve switching investments, either by selling an instrument and buying another or by exercising a right to make a change in regard to an existing instrument, investment firms shall collect the necessary information on the client's existing investments and the recommended new investments and shall undertake an analysis of the costs and benefits of the switch, such that they are reasonably able to demonstrate that the benefits of switching are greater than the costs.

Article 55 Provisions common to the assessment of suitability or appropriateness (Article 25(2) and 25(3) of Directive 2014/65/EU)

1. Investment firms shall ensure that the information regarding a client's or potential client's knowledge and experience in the investment field includes the following, to the extent appropriate to the nature of the client, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved:

(a) the types of service, transaction and financial instrument with which the client is familiar;
(b) the nature, volume, and frequency of the client's transactions in financial instruments and the period over which they have been carried out;
(c) the level of education, and profession or relevant former profession of the client or potential client.

2. An investment firm shall not discourage a client or potential client from providing information required for the purposes of Article 25(2) and (3) of Directive 2014/65/EU.
3. An investment firm shall be entitled to rely on the information provided by its clients or potential clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete.

Article 56 Assessment of appropriateness and related record-keeping obligations (Article 25(3) and 25(5) of Directive 2014/65/EU)

1. Investment firms, shall determine whether that client has the necessary experience and knowledge in order to understand the risks involved in relation to the product or investment service offered or demanded when assessing whether an investment service as referred to in Article 25(3) of Directive 2014/65/EU is appropriate for a client.

An investment firm shall be entitled to assume that a professional client has the necessary experience and knowledge in order to understand the risks involved in relation to those particular investment services or transactions, or types of transaction or product, for which the client is classified as a professional client.

7.1 Assessing the suitability or appropriateness of insurance-based investment products

Information to obtain when assessing the suitability and appropriateness of insurance-based investment products

1. Many stakeholders agreed with EIOPA that the assessment of suitability is one of the most relevant regulatory obligations for the purposes of consumer protection. In accordance with this obligation, distributors providing advice have to provide suitable personal recommendations regarding insurance-based investment products to their customers or potential customers. Suitability has to be assessed against the customer's knowledge and experience, financial situation and investment objectives.

Relationship between the "demands and needs" test and the suitability and appropriateness assessments

2. The assessment of suitability and appropriateness is, according to Article 30(1) and 30(2) of IDD, respectively, without prejudice to the "demands and needs" test of Article 20(1) of IDD. (This point is also explicitly recognised in the technical advice below). Before concluding an insurance contract and irrespective of whether this contract is concluded on an advised or non-advised basis, the distributor has to specify the **demands and the needs** of a customer and has to provide the customer with objective information about the insurance product in a comprehensible form to allow that customer to make an informed decision. For that reason, not just insurance-based investment products, but any insurance contract proposed has to be consistent with the customer's insurance demands and needs. Where advice is provided prior to the conclusion of an insurance contract, the distributor should inform the customer why a particular product would best meet the customer's demands and needs.

3. EIOPA appreciates that there is a close relationship between the "demands and needs" test in Article 20(1) of IDD and the suitability/appropriateness assessment under Article 30 of IDD. Although this close relationship exists, EIOPA does not consider it appropriate, at this stage, to develop rules on the demands and needs test in the context of distribution of insurance-based investment products. It is EIOPA's understanding that, due to the fact that the Commission's empowerment for delegated acts on this issue under Article 30(6) of IDD is limited to the "information to obtain under the suitability/appropriateness assessment" (and not the "demands and needs" test) and the fact that this is also reflected in the Commission's Request for Advice, its technical advice should be limited to the information to obtain under the suitability/appropriateness assessment only. This is also in line with the request by the Commission to EIOPA to ensure regulatory consistency with the line taken in the Commission Delegated Regulation under MiFID II.

Information to be obtained from the customer under the suitability and appropriateness assessments

4. Advice is defined as *"the provision of a personal recommendation to a customer, either upon their request or at the initiative of the insurance distributor, in respect of one or more insurance contracts"*[30]. Therefore, advice is not limited just to the point of sale, but can be provided at any time during the customer relationship. Situations, where periodic advice is provided and recurring

[30] Article 2(1)(15), IDD

assessments of suitability are carried out, are just one example of advice during the customer relationship. Every personal recommendation given to the customer has to be suitable, which includes, for example, whether or not to switch embedded investment elements or to hold or sell an insurance-based investment product.

5. The customer's knowledge and experience is a common criterion when assessing suitability or appropriateness. Therefore, assessing the customer's knowledge and experience is relevant to the assessment of suitability and appropriateness equally.

6. The Technical Advice below sets out requirements with regard to the information to obtain for the assessment of suitability and appropriateness and has been adjusted to take into account, specificities arising from the insurance sector:

   a) Where concepts/terminology contained in MiFID II (e.g. execution of orders, portfolio management) do not exist in the insurance sector;

   b) Where the MiFID framework allows for assumptions with regard to the assessment of suitability and appropriateness of professional clients[31], as there is no specific client classification provided for in IDD (other than an exemption in certain cases for "large risks"[32]).

7. In addition, in the case of Article 54(9)[33] of the draft MiFID II Delegated Regulation, there is perceived to be an overlap with the envisaged Level 2 provisions on product oversight and governance. For this reason, Article 54(9) has not been replicated in the technical advice below. Copying across Article 54(9), could, in EIOPA's view, create some confusion and legal uncertainty with the product oversight and governance provisions in the envisaged Delegated Act under IDD. At the same time, EIOPA differentiates product oversight and governance clearly from the assessment of suitability and appropriateness by specifying that the rules for the latter apply only when there is direct customer contact while carrying out insurance distribution activities.

8. Furthermore, EIOPA also sees the following difference between the equivalent Level 1 provisions of MiFID II and IDD: There is no comparable provision in Article 25 of IDD, to subparagraph 2 of Article 24(2) of MiFID II which states that an "investment firm shall understand the financial instruments they offer or <u>recommend</u>……". There is an equivalent provision in subparagraph 4 of Article 25(1) of IDD with subparagraph 4 of Article 16(3) of MiFID II, which refers to the fact that the "insurance undertaking shall understand and regularly review the insurance products it offers <u>or markets</u>". The IDD text does not go as far as referring to a "recommendation". A "recommendation" would provide an obvious link to the suitability assessment under Article 30(1) of IDD. Furthermore, the provision in subparagraph 4 of Article 25(1) of IDD only applies to insurance undertakings and not insurance intermediaries, whereas Article 30(1) of IDD covers both insurance intermediaries and insurance undertakings.

9. EIOPA is of the view that a personal recommendation can only be provided, where the relevant information is available to the distributor. EIOPA acknowledges that understanding the consequences of not being able to provide a personal recommendation is important for distribution activities. Where feasible

[31] Article 22(1)2), IDD

[32] Article 22(1)(1), IDD. N.B. "Large risks" only cover certain non-life products in Annex I of the Solvency II Directive.

[33] *"Investment firms shall have, and be able to demonstrate, adequate policies and procedures in place to ensure that they understand the nature, features, including costs and risks of investment services and financial instruments selected their clients and that they assess, while taking into account cost and complexity, whether equivalent investment services or financial instruments can meet their client's profile".*

under national law, if a suitability assessment cannot be performed because the necessary information about the customer’s financial situation and investment objectives cannot be obtained, an appropriateness assessment could be performed instead on a non-advised basis. However, in cases of Article 30(2) of IDD, in relation to non-professional customers, it would need to be clear to the customer or potential customer that he is not receiving a personal recommendation.

Technical Advice

Assessment of suitability

1. The insurance intermediary or insurance undertaking when carrying out an insurance distribution activity, shall determine the extent of the information to be collected from the customer in light of all the features of the advice to be provided to the customer or potential customer.
2. 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) of Directive (EU) 2016/97, 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 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, 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.

3. It may be the case that some information to be obtained for the suitability assessment is obtained already under Chapter V of Directive (EU) 2016/97.
4. The insurance intermediary or the insurance undertaking shall not create any ambiguity or confusion about their responsibilities in the process when assessing the suitability in accordance with Article 30(1) of Directive (EU) 2016/97. The insurance intermediary or insurance undertaking shall inform customers, clearly and simply, that the reason for assessing suitability is to enable them to act in the customer's best interest.
5. When advice on insurance-based investment products is provided in whole or in part through an automated or semi-automated system, the responsibility to undertake the suitability assessment shall lie with the insurance intermediary or insurance undertaking providing the service and shall not be reduced by the use of an electronic system in making the personal recommendation.
6. The necessary information regarding the customer's or potential customer's financial situation including that person's ability to bear losses, shall include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments. The level of information gathered shall be appropriate to the specific type of product or service being considered.
7. The necessary information regarding the customer's or potential customer's investment objectives, including that person's risk tolerance, shall include, where relevant, information on the length of time for which the customer wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment. The level of information gathered shall be appropriate to the specific type of product or service being considered.

8. With reference to group insurance as referred to in recital 49 of Directive (EU) 2016/97, where an insurance contract is concluded on behalf of a group of members, where the individual member cannot take an individual decision to join, the insurance intermediary or insurance undertaking shall establish and implement policy as to who shall be subject to the suitability assessment and how this assessment will be done in practice, including from whom the information about knowledge and experience, financial situation and investment objectives shall be collected. The insurance intermediary or the insurance undertaking shall record this policy.

9. The insurance intermediary or insurance undertaking shall take reasonable steps to ensure that the information collected about the customer is reliable. This shall include, but shall not be limited to, the following:

(a) ensuring customers are aware of the importance of providing accurate and up-to-date information;

(b) ensuring all tools, such as risk assessment profiling tools or tools to assess a customer's knowledge and experience, employed in the suitability assessment process are fit-for-purpose and appropriately designed for use with their customers, with any limitations identified and actively mitigated through the suitability assessment process;

(c) ensuring questions used in the process are likely to be understood by the customer, capture an accurate reflection of the customer's objectives and needs, and the information necessary to undertake the suitability assessment; and

(d) taking steps, as appropriate, to ensure the consistency of customer information, such as considering whether there are obvious inaccuracies in the information provided by the customer.

10. If the insurance intermediary or insurance undertaking does not obtain the information required under Article 30(1) of Directive (EU) 2016/97, the insurance intermediary or the insurance undertaking shall not provide advice on insurance-based investment products to the customer or potential customer.

11. When providing the advice, an insurance intermediary or the insurance undertaking shall not make a recommendation where none of the products are suitable for the customer.

12. When providing advice that involves switching between underlying investment assets, such as by exercising a contractual right to make a change in regard to an underlying investment asset, the insurance intermediary or insurance undertaking shall also collect the necessary information on the customer's existing underlying investment assets and the recommended new investments and shall undertake an analysis of the costs and benefits of the switch, such that they are reasonably able to demonstrate that the benefits of switching are greater than the costs.

Provisions common to the assessment of suitability or appropriateness

13. The necessary information regarding the customer's or potential customer's knowledge and experience in the investment field, shall include, where relevant the following to the extent appropriate to the specific type of product or service:

(a) the types of service, transaction, insurance-based investment product or financial instrument with which the customer is familiar;

(b) the nature, volume, and frequency of the customer's transactions in insurance-based investment products or financial instruments and the period over which they have been carried out;

(c) the level of education, and profession or relevant former profession of the customer or potential customer.

14. An insurance intermediary or the insurance undertaking shall not discourage a customer or potential customer from providing information required for the purposes of Article 30(1) and (2) of Directive (EU) 2016/97.

15. An insurance intermediary or the insurance undertaking shall be entitled to rely on the information provided by its customers or potential customers unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete.

Assessment of appropriateness

16. 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) of Directive (EU) 2016/97, the insurance intermediary or insurance undertaking, when carrying out insurance distribution activities other than those referred to in Article 30(1) of Directive (EU) 2016/97, in relation to assessing the appropriateness of sales where no advice is given, shall determine whether that customer has the necessary experience and knowledge in order to understand the risks involved in relation to the product proposed.

7.2 Retention of records

Analysis

1. The technical advice developed by ESMA on MIFID II and the Delegated Regulation under MiFID II adopted by the European Commission on 25 April 2016 have served as a basis for this part of the technical advice. The results of EIOPA's online survey in early 2016[34] showed a general support for alignment with MIFID II requirements, which was reinforced by the outcome of the public consultation. Respondents agreed that insurance specificities should be taken into account in the technical advice.

2. EIOPA acknowledges that the draft MiFID II Delegated Regulation covers record-keeping in an appropriateness scenario only, and does not introduce specific rules for the content of records for the suitability assessment. Furthermore, the draft MiFID II Delegated Regulation does not provide more information about the format for records. EIOPA has taken note of ESMA's Guidelines on certain aspects of the MiFID suitability requirements[35], where certain expectations with regard to record-keeping of the assessment of suitability were set.

3. With particular reference to the content of the agreements for the provision of services to customer, the draft MiFID II Delegated Regulation does not reflect specificities of the insurance sector. In particular, it refers to the written basic agreement between the investment firm and the retail client, which Member State will require the investment firm to enter into with the latter, as provided by Article 58, draft MiFID II Delegated Regulation. Taking into account that the same written basic agreement is not foreseen by IDD, the reference to *"the agreements for the provision of services to customers"* mentioned by the Commission's request for advice, does not seem to be applicable in the IDD context. IDD mentions the documents agreed between the parties only, but does not introduce the concept of a written basic agreement.

4. Therefore, the reference to the written basic agreements for the provision of services to the customer could be interpreted as a reference to the contractual terms and conditions in which the essential rights and obligations of the parties are regulated. Member States might want to introduce this concept at their own discretion or have done so already.

5. In fact, although from a formal point of view, IDD does not introduce the concept and the requirement of the written basic agreement (but only mentions the documents agreed between the insurance intermediary or insurance undertaking and the customer), the content of the written basic agreement does not appear inconsistent with the IDD framework, except for those features specifically referred to under MiFID II and not adapted to the specificities of the insurance market (e.g. the reference to portfolio management, custody services and financing transactions).

Retention of records on suitability assessments

6. As regards the Commission's request for advice about the content of the agreements for the provision of services to customers, it was also pointed out by many respondents to EIOPA's online survey that the fact that the content of insurance contracts is already regulated at national level, should be also taken into account. Therefore, the definition of the information to be included in the contract at EU level could interfere with national civil law. For this reason, with

[34] https://eiopa.europa.eu/Pages/Consumer-Protection/Online-survey-Call-for-Advice-from-EC-IDD.aspx
[35] Section V.IX on Record-keeping: https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-387_en.pdf

reference to the documents agreed between the insurance intermediary or insurance undertaking and the customer setting out the rights and obligation of the parties which the insurance intermediary or insurance undertaking is obliged to record, the rules on retention of records remain high level.

7. As regards the content of records on suitability assessments, the insurance intermediary or insurance undertaking should keep a record of the insurance-based investment products that were recommended, but not record all potential products that could have been alternatives. This ensures that the provision of advice and the record-keeping obligations for this service are aligned.

Format of the documents agreed between the parties

8. In relation to the Commission's request for advice about the format of records and agreements for the provision of services to customers, Article 30(5) of IDD already refers to "durable medium" in relation to periodic reports to customers on the services provided and to the suitability statements to be provided to the customer.

9. EIOPA has taken note that the draft MiFID II Delegated Regulation has a number of provisions on format, such as Articles 46 and Article 58. Accordingly, the technical advice specifies the format for record-keeping and reporting purposes to make Article 30 of IDD, more practical and allow national competent authorities to supervise market practice.

10. Therefore, it would be sufficient to make a reference to the notion of durable medium as defined by Article 2(1)(18) of IDD, which states the following:

"'durable medium' means any instrument which:

> *(a) enables a customer to store information addressed personally to that customer in a way accessible for future reference and for a period of time adequate for the purposes of the information; and*
>
> *(b) allows the unchanged reproduction of the information stored".*

11. EIOPA acknowledges the challenges for distributors with regard to providing documents in the most suitable format. EIOPA believes it is useful to make a reference to the general provisions on the information conditions laid down by Article 23 of IDD (as regards the use of paper or another durable medium and the use of the official language of the Member State in which the risk is situated or of the Member State of the commitment or in any other language agreed upon by the parties).

12. Article 23 introduces certain criteria when deviating from the default paper-based format. These criteria should be understood in a pragmatic way that is in accordance with the best interests of the customer.

Technical Advice

Retention of records

1. Without prejudice to the application of the Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 (General Data Protection Rules), the insurance intermediary or insurance undertaking shall keep orderly records of information obtained where the insurance intermediary or the insurance undertaking is required to produce a suitability statement or the customer information obtained to assess appropriateness.

Record-keeping obligations for the assessment of suitability

2. The insurance intermediary or the insurance undertaking shall at least:

(a) maintain adequate recording and retention arrangements to ensure orderly and transparent record-keeping regarding the suitability assessment, including any advice provided, the result of the suitability assessment and all changes to the underlying investment assets; in order to not prevent competent authorities from fulfilling their supervisory objectives with particular reference to the detection of failures;

(b) ensure that records kept are accessible for the relevant persons within the insurance intermediary or insurance undertaking, and for competent authorities; and

(c) have adequate processes to mitigate any shortcomings or limitations of the record-keeping arrangements.

3. The insurance intermediary or the insurance undertaking shall record all relevant information about the suitability assessment, such as information about the customer, and information about insurance-based investment products recommended to the customer or purchased on the customer's behalf. Those records shall include:

(a) any changes made by the insurance intermediary or the insurance undertaking regarding the suitability assessment, in particular any change to the customer's risk tolerance;

(b) the recommended insurance-based investment products that fit that profile and the rationale for the individual assessment, as well as any changes and the reasons for them.

Record-keeping obligations for the assessment of appropriateness

4. Insurance intermediary or insurance undertaking shall maintain records of the appropriateness assessments undertaken which shall include the following:

(a) the result of the appropriateness assessment;

(b) any warning given to the customer where the product was assessed as potentially inappropriate for the customer, whether the customer asked to proceed with concluding the contract despite the warning and, where applicable, whether the insurance undertaking or the insurance intermediary accepted the customer's request to proceed with concluding the contract; and

(c) any warning given to the customer where the customer did not provide sufficient information to enable the insurance undertaking or the insurance

intermediary to undertake an appropriateness assessment, whether the customer asked to proceed with concluding the contract despite this warning and, where applicable, whether the insurance undertaking or the insurance intermediary accepted the customer's request to proceed with concluding the contract.

Format

5. With reference to the format, the documents as referred to in paragraph 1 shall be kept and provided:

a) in an official language of the Member State in which the risk is situated or in the Member State where the consumer has his habitual residence under the conditions of Article 6 of the Regulation 593/2008 on the law applicable to contractual obligations (Rome I) or in any other language agreed upon by the parties;

b) in a clear and accurate manner, comprehensible to the customer;

c) in the format as defined by Article 2(1)(18) of Directive (EU) 2016/97.

7.3 Reports to customers on the services provided

Analysis

1. EIOPA has been asked to provide advice on periodic reports to customers on the services provided. Notwithstanding that the suitability statement is a one-off document, EIOPA has included the suitability statement in this part of the analysis and advice. EIOPA is of the view that providing the one-off statement and a periodic suitability assessment should be dealt with together.
2. Reporting obligations should include a fair and balanced review of the activities undertaken and of the performance during the relevant period. The reports on the services provided, should be provided in a durable medium.

Suitability statement

3. EIOPA acknowledges that distributors, when providing advice, will usually take into account all information available. The IDD includes in Chapter V, the demands and needs test, which existed already in the IMD and is applicable to all insurance contracts. According to Article 20(1) of IDD, prior to the conclusion of an insurance contract, the insurance distributor shall specify, on the basis of information obtained from the customer, the demands and the needs of that customer. EIOPA expects that the suitability statement will focus on the elements of the suitability assessment and does not intend to introduce with its technical advice, any form of mandatory "demands and needs statement".
4. When an advice is provided to the customer regarding insurance-based investment products, the suitability statement has to provide feedback on the customer-specific information, which has been gathered and analysed in order to make the recommendation of a suitable contract, transparent.
5. The suitability statement should therefore contain at least:
   - An outline of the advice given; and
   - How the recommendation provided, is suitable for the customer.

Periodic Suitability report

6. EIOPA considers the periodic suitability report referred to in Article 30(5) of IDD to be an on-going and regular revision of the initial suitability assessment, to be agreed upon by the parties, with the aim of determining whether the product is still in accordance with the best interests of their customers. Taking into account that insurance-based investment products have usually medium to long recommended holding periods, a frequency of one year is appropriate to meet the objectives.
7. EIOPA considers it proportionate that a periodic suitability report covers in certain circumstances only, changes in the services or investments embedded in the insurance-based investment product and/or the circumstances of the customer and may not need to repeat all the details of the first report.
8. In the cases where a periodic assessment of suitability is agreed, a customer should be able to trust that this review takes place at least annually. However, if the assessment shows that the product is not in accordance with the best interests of the customer anymore, the customer should be informed without undue delay after the assessment.
9. If the assessment shows that the product is still suitable, EIOPA considers it sufficient to refer to the periodic assessment in the periodic communications to

the customer. This would also be proportionate and would not overwhelm the customer with too much information.

Periodic communications to customers

10. EIOPA understands that adequate reports on the service provided are mandatory according to Article 30(5) of IDD. In practice, they might not be separable from other customer communication and could be delivered together with other documents or even electronically.

11. EIOPA refers in its technical advice to services provided to and transactions undertaken on behalf of customers. This is due to the fact that IDD specifies that *"reports shall include periodic communications to customers, taking into account the type and the complexity of insurance-based investment products involved and the nature of the service provided to the customer and shall include, where applicable, the costs associated with the transactions and services undertaken on behalf of the customer*". EIOPA expects the periodic communication to disclose to the customer the costs that are incurred by transactions, which is understood with regard to changes to the underlying investment assets in insurance-based investment products.

12. The recommended frequency of adequate reports on the service provided should be yearly. EIOPA acknowledges that reporting under MiFID II in the case of portfolio management, foresees quarterly reporting. However, substantial differences exist in EIOPA's view between reporting with regard to portfolio management and periodic communications with regard to insurance-based investment products. Mainly, in the case of insurance-based investment products, the recommended holding period is generally several years, whereas portfolio management can encompass all sorts of financial instruments to report on.

13. At the same time, EIOPA recognises the similarities of portfolio management and periodic communications with regard to insurance-based investment products. Therefore, EIOPA considers it important to report on relevant information. EIOPA has reviewed such information in light of the responses received during the public consultation. It is not EIOPA's intention to call into question the reporting already foreseen under Article 185 of Solvency II. Furthermore, the reporting criteria should be in principle applicable to all kinds of insurance-based investment products. Therefore, EIOPA is putting forward a proposal for core elements of relevant customer information, while acknowledging that other information provision clauses exist in relevant legislation.

14. With the proposed amendments to the list of elements required for meaningful periodic communication to customers, EIOPA expects in practice a clearer demarcation of reporting obligations for insurance undertakings (reporting foreseen by Article 185 of Solvency II) and periodic communications following from the direct customer relationship, Article 30(5) of IDD. EIOPA expects that the periodic communication goes beyond the criteria prescribed, if the products involved or the nature of the service provided warrant for the communication of additional elements. Ultimately, customers should be informed about the necessary developments while not being overloaded with too much information.

Technical Advice

Suitability statement

1. When providing advice, the insurance intermediary or insurance undertaking shall provide a statement to the customer that includes an outline of the advice given and how the recommendation provided is suitable for the customer, including how it meets the customer's investment objectives, including that person's risk tolerance; the customer's financial situation, including that person's ability to bear losses; and the customer's knowledge and experience.
2. The insurance intermediary or insurance undertaking shall draw the customer's attention to, and shall include in the suitability statement, information on whether the recommendation is likely to require the customer to seek a periodic review of their arrangements.
3. Where an insurance intermediary or insurance undertaking has informed the customer that it will carry out a periodic assessment of suitability, the subsequent reports after the initial service is established, may only cover changes in the services or underlying investment assets and/or the circumstances of the customer and may not need to repeat all the details of the first report.
4. Insurance intermediary or insurance undertaking providing a periodic suitability assessment shall review, in accordance with the best interests of their customers, the suitability of the recommendations given at least annually.
5. The frequency of this assessment shall be increased depending on the characteristics of the customer, such as the risk tolerance of the customer, and the insurance-based investment product recommended.
6. The insurance intermediary or insurance undertaking providing a periodic suitability assessment pursuant to paragraph 3, shall disclose all of the following:

(a) the frequency and extent of the periodic suitability assessment and where relevant, the conditions that trigger that assessment;

(b) the extent to which the information previously collected will be subject to reassessment; and

(c) the way in which an updated recommendation will be communicated to the customer.

Periodic communications to customers

7. Without prejudice to Article 185 of Directive 2009/138/EC (Solvency II), the insurance intermediary or insurance undertaking shall provide the customer with a periodic statement in a durable medium of the services provided to and transactions undertaken on behalf of that customer.