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Consultation Paper on Conflicts of Interest in direct and intermediated sales of insurance-based investment products

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Table of Contents

1. Responding to the Consultation Paper

EIOPA welcomes comments on the Consultation Paper on Conflicts of Interest in direct and intermediated sales of insurance-based products (PRIIPs).

This package includes:

- The Consultation Paper
- Template for comments.

EIOPA invites comments on any aspect of this paper and in particular on the specific questions summarised in Annex II. Comments are most helpful if they:

- respond to the question stated, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA in the provided Template for Comments, by email to CP-102-IMD@eiopa.europa.eu, by 18:00 CET on **1st December 2014**.

Contributions not received in the provided template for comments, or sent to a different email address, or after deadline, will not be processed.

Publication of responses

Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an e-mail message will not be treated as a request for non-disclosure.

Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA's rules on public access to documents[1].

Contributions will be made available at the end of the public consultation period.

Data protection

Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published. They will only be used to request clarifications if necessary on the information supplied.

EIOPA, as a European Authority, will process any personal data in line with Regulation (EC) No 45/2001 on the protection of the individuals with regards to the processing of personal data by the Community institutions and bodies and on the free movement of

[1] https://eiopa.europa.eu/fileadmin/tx_dam/files/aboutceiops/Public-Access-(EIOPA-MB-11-051).pdf

such data. More information on data protection can be found at www.eiopa.europa.eu under the heading ‘Legal notice’.

2. Reasons for publication

On 14 January 2014, the European Parliament and the European Council reached a political agreement with regard to the revision of the Markets in Financial Instruments Directive (Directive 2004/39/EC) (hereafter "MiFID I"). Subsequent to the political agreement, the final legislative proposals of the new Markets in Financial Instruments Directive (Directive 2014/65/EU) (hereinafter "MiFID II"), and the Markets in Financial Instruments Regulation (Regulation (EU) No 600/2014) were approved by the European Parliament on 15 April 2014 and by the European Council on 13 May 2014. Both were published on 12 June 2014 in the Official Journal of the European Union and entered into force on 2 July 2014.

The majority of the new rules concern the regulation of the markets for financial instruments and the participants in these markets. In order to strengthen investor protection and to further develop a level playing field for different types of investments, MiFID II also included amendments to the Insurance Mediation Directive (Directive 2002/92/EC) (hereafter "the amended IMD") addressing insurance intermediaries and insurance undertakings. These amendments can be found in Article 91 of MiFID II, which introduces into the IMD, for the sale of insurance-based investment products, certain elements of the conduct of business rules contained within MiFID I. Insurance-based investment products are defined in the amendments, and cover life-insurance contracts which have a *"maturity or surrender value [that] is wholly or partially exposed, directly or indirectly, to market fluctuations"*[2].

In particular, the amendments in Article 91 of MiFID II introduce new organisational requirements for insurance intermediaries and insurance undertakings with regard to conflicts of interest. For that purpose, the IMD has been amended by a new Article 13b which requires insurance undertakings and insurance intermediaries to take all reasonable steps to prevent conflicts of interest from adversely affecting the interests of their customers and by a new Article 13c, specifying how to identify and manage conflicts of interest that arise in the course of carrying out insurance distribution activities. Article 13c (3)(a) and (b) empower the Commission to adopt delegated acts to further define the steps insurance undertakings and insurance intermediaries have to take to identify, prevent, manage and disclose conflicts of interest, as well as to establish criteria for determining the types of conflict of interest that may damage the interests of the customers.

[2] The amended IMD includes in Art. 2 (13) a definition of "insurance-based investment products" comprising insurance products which offer a maturity or surrender value, where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations and shall not include:

(a) non-life insurance products as listed in Annex I of Directive 2009/138/EC (Classes of Non-life Insurance);
(b) life insurance contracts where the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity;
(c) pension products which, under national law, are recognised as having the primary purpose of providing the investor with an income in retirement, and which entitles the investor to certain benefits;
(d) officially recognised occupational pension schemes falling under the scope of Directive 2003/41/EC or Directive 2009/138/EC;
(e) individual pension products for which a financial contribution from the employer is required by national law and where the employer or the employee has no choice as to the pension product or provider.

The European Insurance and Occupational Pensions Authority (hereinafter EIOPA) received a formal request (mandate)[3] from the Commission on 19 May 2014 to provide technical advice to assist the Commission on the possible content of the delegated acts.

For the purposes of consistency, the Commission has invited EIOPA to consider the existing conflicts of interest framework under the current MiFID Implementing Directive (Directive 2006/73/EC) (hereafter "MiFID Implementing Directive") and to develop a similar framework for insurance intermediaries and insurance undertakings distributing insurance-based investment products.

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 a Discussion Paper on 21 May 2014.

Many respondents to the Discussion Paper emphasized that the rules on conflict of interest which can be found in the MiFID Implementing Directive should carefully be adapted to the specificities of the insurance sector. Furthermore, many argued in favour of clarification that the principles of proportionality should be applicable to avoid excessive administrative burden and costs, especially with regard to small undertakings and sole traders[4]. Many respondents also expressed concerns that too far-reaching implementing measures on inducements could lead to a *de facto* ban on commission-based business models. A number mentioned, however, the crucial importance of such measures in their view from the perspective of the customer.

Having taken account of the feedback received from stakeholders, EIOPA has prepared this Consultation Paper which presents, in more detail, the recommendations that EIOPA considers including in its Technical Advice to the Commission. Interested parties are invited to comment on these proposals.

EIOPA has been 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 has 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.

In order to gather feedback from market participants and interested parties, EIOPA has already included a high-level assessment of possible impacts within its Discussion Paper, accompanied by specific questions. EIOPA is now considering the feedback received on the Discussion Paper, in order to prepare a submission on possible

[3] "Formal Request to EIOPA for technical advice on possible delegated acts concerning Directive 2002/92/EC on insurance mediation, as amended by the Directive on Markets in Financial Instruments repealing Directive 2004/39/EC (MiFID (EC) NO XX/2014)" (Ref. Ares(2014)1622155 - 19/05/2014): http://ec.europa.eu/internal_market/securities/docs/isd/mifid/140514-mandate-eiopa_en.doc.pdf

[4] Sole Trader", in this context, is a natural person, in other words a person who runs a business by himself/herself.

impacts alongside its Technical Advice. In developing this submission, EIOPA will also build upon the impact assessment work undertaken by the Commission for the revisions of the IMD and MiFID.

To further gather input from market participants and interested parties, EIOPA has also included specific questions in this Consultation Paper related to the assessment of impacts. EIOPA acknowledges that the impact of the proposals may differ significantly because of different market structures and already existing regulatory regimes in the different Member States of the European Union. In order to enable a thorough assessment, respondents are therefore invited to provide EIOPA with any data that they have related to the possible impacts of the proposals outlined.

Questions to stakeholders:

Q1: What would you estimate as the costs and benefits of the possible changes outlined in this Consultation?

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

3. Legal background

The new organisational requirements for insurance intermediaries and insurance undertakings with regard to conflict of interest can be found in Article 13b and Article 13c of the amended IMD.

Article 13b states:

> "An insurance intermediary or insurance undertaking 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 in Article 13c, from adversely affecting the interests of its customers."

Article 13c states:

> "1. Member States shall require insurance intermediaries and insurance undertakings to take all appropriate steps to identify conflicts of interest between themselves, including their managers, employees and tied insurance intermediaries, 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 13b 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 and/or sources of conflicts of interest before undertaking business on its behalf.
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> 3. The Commission shall be empowered to adopt by means of delegated acts, in accordance with Article 13f, the following measures:
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> (a) to define the steps that insurance intermediaries or insurance undertakings might reasonably be expected to take to identify, prevent, manage and disclose conflicts of interest when carrying out insurance distribution activities;
> (b) to 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."

4. Minimum Criteria for the Identification of Conflicts of Interest

The Commission's request for advice

EIOPA is invited to provide technical advice on the following issue:

"To 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".

With a view to establishing appropriate criteria for determining the types of conflict of interest whose existence may damage the interests of the customers or potential customers of insurance-based investment products, EIOPA has been invited to verify to what extent the criteria in the MiFID Implementing Directive, need to be adapted and/or supplemented for insurance-based investment products.

Different products as well as different distribution channels might present different conflict of interest risks. EIOPA should also consider the timeframe of insurance-based investment products – notably what the conflict of interest issues are at the point of sale as well as during the products' lifetime.

MiFID Implementing Directive

The criteria for determining which types of conflict of interest may damage the interests of a client of an investment firm can be found in Article 21 of the MiFID Implementing Directive.

Article 21 states:

> "Member States shall ensure that, for the purposes of identifying the types of conflict of interest that arise in the course of providing investment and ancillary services or a combination thereof and whose existence may damage the interests of a client, investment firms take into account, by way of minimum criteria, the question of whether the investment firm or a relevant person, or a person directly or indirectly linked by control to the firm, is in any of the following situations, whether as a result of providing investment or ancillary services or investment activities or otherwise:
>
> (a) the firm or that person is likely to make a financial gain, or avoid a financial loss, at the expense of the client;
> (b) the firm or that person has an interest in the outcome of a service provided to the client or of a transaction carried out on behalf of the client, which is distinct from the client's interest in that outcome;
> (c) the firm or that person has a financial or other incentive to favour the interest of another client or group of clients over the interests of the client;
> (d) the firm or that person carries on the same business as the client;

(e) the firm or that person receives or will receive from a person other than the client an inducement in relation to a service provided to the client, in the form of monies, goods or services, other than the standard commission or fee for that service."

Analysis

Even though Article 21 of the MiFID Implementing Directive addresses investment firms only, EIOPA notes that the instances circumscribed in the provision are of a broad and abstract nature, such that they, in principle, can be applied very broadly across the different sectors of the financial services. The instances rather describe situations where conflicts of interest commonly arise when a commercial activity is pursued and the interests of clients are at stake. The interest to make a financial gain at the expense of the clients is a good example. Consequently, EIOPA considers that the principles as laid down in letters (a) – (e) are also relevant for insurance intermediaries and insurance undertakings in the course of carrying out insurance distribution activities.

EIOPA also considers that, in view of the abstract wording of Article 21, the provision encompasses all circumstances which EIOPA's predecessor, CEIOPS, considered as possible situations where conflicts of interest arise with regard to the distribution of insurance-based investment products in its advice to the Commission on the revision of the IMD[5]. The same is true with regard to the situations described in the 3L3 report on PRIPS published by the three Lamfalussy Committees (CEBS, CESR and CEIOPS)[6].

Consequently, EIOPA considers it generally appropriate to make recourse to Article 21 of the MiFID Implementing Directive as the basis for the technical advice. Nevertheless, EIOPA recommends adapting and amending the provision, not only from a terminological point of view to take account of insurance-specific legal context (e.g. replacing "client" by "customer" as the term "customer" is used in the IMD), but also for the purpose of clarification in order to capture instances specific matters to the insurance sector.

In this regard, EIOPA considers it important to clarify that relevant conflicts of interest may also arise with regard to the development and management of products. For instance, the involvement of an intermediary may be beneficial for customers, as the intermediary may have a better understanding of the customers' needs and investment objectives than the insurance undertaking as manufacturer of the product, however this observation does not automatically exclude all conflicts of interest that may arise in such a context. For example, conflicts of interest could arise where an intermediary exercises influence over how distribution costs that benefit the intermediary are embedded in the design of a product, or where an intermediary is rewarded with a percentage of the management costs. Other possible conflicts of interest related to the development and management of products might arise where

[5] https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/submissionstotheec/20101111-CEIOPS-Advice-on-IMD-Revision.pdf
[6] https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/submissionstotheec/20101012-3L3-TF-Report-on-PRIPs.pdf

insurance undertakings accept payments from investment providers such as asset managers, who are seeking to distribute their investments as units within the insurance undertaking's relevant products.

Furthermore, EIOPA believes that conflicts of interest may arise whenever the insurance intermediary receives a commission or fee paid by a third party, independent from the question whether the commission or fee corresponds with the market standard or not. This follows from the intermediary's own interest to make a financial gain when providing services to the customers. With regard to the obligation to identify conflicts of interest, EIOPA consequently proposes that the minimum criterion which is listed in Art. 21(e) of the MiFID Implementing Directive should not exempt standard commissions and fees, but should apply to all commissions and fees paid by a third party.

Pursuant to Article 13c paragraph 1 of the amended IMD, insurance intermediaries and insurance undertakings should address all conflicts of interests that arise in the course of carrying out any insurance distribution activities. EIOPA underlines that "insurance distribution activities" should be understood in a broad manner, not restricted to the point of sale.

Against this background, EIOPA notes that conflicts of interests may occur in a variety of situations not limited to the point in time when the product is recommended and sold to the customer. As outlined above, conflicts of interest may already arise when the product is designed, but also during the whole lifetime of a product and the entire contractual relationship with the customer. Recommendations to switch products or options within a product, which may offer a higher commissions to the distributor, but may offer no added value or, overall, lead to lower returns due to additional costs, are a good example where the interest of a distributor to gain higher commissions conflicts with the interest of the customer.

Further guidance on the application of organisational requirements

EIOPA acknowledges that the new organisational requirements on the identification and management of conflicts of interest, in particular due to their abstract nature, raise the question on how these rules should be applied in practise by insurance intermediaries and insurance undertakings.

Even though EIOPA concedes that further guidance is needed to clarify the application of these new requirements with regard to the insurance sector specificities, EIOPA does not consider it appropriate to replace these general principles by a more detailed approach.

This follows from the notion that high-level principles can be applied to a wide variety of business models of insurance intermediaries and insurance undertakings as well as from the given fact that they can better take into account the specifics of the national markets. Therefore, EIOPA believes that the implementing measures should only be more specified addressing distinctive instances at the level of principles and not

provide individual examples (e.g. how conflicts of interest may be addressed in a given situation). From EIOPA's perspective, such an approach would rather create legal uncertainty as it could never entail all possible circumstances and situations.

Instead, in addition, EIOPA proposes to provide further guidance and to enhance convergence in the application of the requirements by issuing Guidelines and or an Opinion at a later stage. Besides individual examples, such Guidelines could also provide "good and bad practices", to aid national authorities and market participants in understanding the expectations of EIOPA with regard to the measures to be taken to identify conflicts of interest appropriately. Consequently, EIOPA plans to develop Guidelines on the procedures and measures insurance intermediaries and insurance undertakings should establish with regard to the identification of conflicts of interest that might arise in the course of carrying out insurance distribution activities.

Draft Technical Advice

Against this background, in EIOPA's view, the implementing measures for the amended IMD (being the equivalent to Article 21 of the MiFID Implementing Directive) should be drafted as follows:

Identification of conflicts of interests

For the purpose of identifying the types of conflict of interest that arise in the course of carrying out any insurance distribution activities and which entail the risk of adversely affecting the interests of a customer, insurance intermediaries and insurance undertakings should take into account, by way of minimum criteria, the question whether they or any person directly or indirectly linked to them or a person involved in carrying out insurance distribution activities for the customer, including those that are involved in the development and management of insurance based investment products, or another customer are in any of the following situations, whether as a result of carrying out insurance distribution activities or otherwise:

a. the insurance intermediary, insurance undertaking, linked person or person involved in carrying out insurance distribution activities is likely to make a financial gain, or avoid a financial loss, at the expense of the customer;
b. the insurance intermediary, insurance undertaking, linked person or person involved in carrying out insurance distribution activities has an interest in the outcome of those activities which is distinct from the customer's interest in that outcome;
c. the insurance intermediary, insurance undertaking, linked person or person involved in carrying out insurance distribution activities has a financial or other incentive to favour the interest of another customer or group of customers over the interests of the customer;
d. the firm or that person carries on the same business as the customer;
e. the insurance intermediary, insurance undertaking, linked person or person involved in carrying out insurance distribution activities 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.

Questions to stakeholders:

Q2: Do you agree that general principles, similar to those set out in Article 21 of the MiFID Implementing Directive, should also be applied to insurance distribution activities, further specified through EIOPA guidelines?

Q3: Do you agree with the adjustments proposed to adapt Article 21 to take into account the specificities of insurance distribution activities?

Q4: Are there any additional adjustments to be made from your point of view?

5. Conflicts of Interest Policy

The Commission's request for advice

EIOPA is invited to provide technical advice on the empowerment of the Commission to define the steps that insurance intermediaries or insurance undertakings might reasonably be expected to take to identify, prevent, manage and disclose conflicts of interest when carrying out insurance distribution activities.

EIOPA is also invited to base its technical advice, primarily, on existing conflict of interest rules, as laid down in Commission Directive 2006/73/EC, while at the same time ensuring regular consultation with ESMA as regards ESMA's work on its technical advice on Article 23(4)(a) and (b) of MiFID II. In this respect, the EIOPA advice should be in line with the MiFID II provisions as much as possible, in so far as it is consistent with the amended IMD.

MiFID Implementing Directive

The MiFID implementing Directive specifies the organisational requirements applicable for investment firms in Article 22 as follows:

"1. Member States shall require investment firms to establish, implement and maintain an effective conflicts of interest policy set out in writing and appropriate to the size and organisation of the firm and the nature, scale and complexity of its business. Where the firm is a member of a group, the policy must also take into account any circumstances, of which the firm 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.

2. The conflicts of interest policy established in accordance with paragraph 1 shall include the following content:

(a) it must identify, with reference to the specific investment services and activities and ancillary services carried out by or on behalf of the investment firm, the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests of one or more clients;

(b) it must specify procedures to be followed and measures to be adopted in order to manage such conflicts.

3. Member States shall ensure that the procedures and measures provided for in paragraph 2(b) are designed to ensure that relevant persons engaged in different business activities involving a conflict of interest of the kind specified in paragraph 2(a) carry on those activities at a level of independence appropriate to the size and activities of the investment firm and of the group to which it belongs, and to the materiality of the risk of damage to the interests of clients. For the purposes of paragraph 2(b), the procedures to be followed and measures to be adopted shall

include such of the following as are necessary and appropriate for the firm to ensure the requisite degree of independence:

(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 harm the interests of one or more clients;
(b) the separate supervision of relevant persons whose principal functions involve carrying out activities on behalf of, or providing services to, clients whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the firm;
(c) the removal of any direct link between the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated by, 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 investment or ancillary services or activities;
(e) measures to prevent or control the simultaneous or sequential involvement of a relevant person in separate investment or ancillary services or activities where such involvement may impair the proper management of conflicts of interest.

If the adoption or the practice of one or more of those measures and procedures does not ensure the requisite degree of independence, Member States shall require investment firms to adopt such alternative or additional measures and procedures as are necessary and appropriate for those purposes.

4. Member States shall ensure that disclosure to clients, pursuant to Article 18(2) of Directive 2004/39/EC, is made in a durable medium and includes sufficient detail, taking into account the nature of the client, to enable that client to take an informed decision with respect to the investment or ancillary service in the context of which the conflict of interest arises".

Analysis

EIOPA considers that Article 22 of the MiFID Implementing Directive is of the same abstract nature as Article 21 of that Directive and includes general principles, not only relevant in the context of investment services, but also with regard to insurance distribution activities. Therefore, EIOPA proposes to transfer these principles and to take them as a basis for drafting the implementing measures for the amended IMD.

Even though the situations addressed in Article 22(3) are drafted in view of investment firms providing a mixture of different kinds of investment services, rather than insurance undertakings and intermediaries, EIOPA believes that similar conflicts of interest may also arise within some insurance undertakings or intermediaries, in particular in view of the variety of business models in existence across Member States.

ESMA's Consultation Paper with regard to the MiFID II proposes to amend the current organisational measures to address conflicts of interest[7]: the disclosure of conflicts should be a step of last resort, limited to cases where conflicts of interest may not be properly managed otherwise. The disclosure should be made in a durable medium and undertakings should be required to review their conflict of interest policies periodically, at least once a year.

EIOPA believes that these amendments are appropriate and should equally be taken as a basis for drafting the implementing measures for the amended IMD.

Further guidance on the application of the principles

As pointed out above, EIOPA is aware that the abstract nature of these general principles raises the question on how these principles should be applied in practice by insurance intermediaries and insurance undertakings.

Again, EIOPA considers it important that further guidance is provided to market participants. Therefore, EIOPA plans to issue Guidelines (or another instrument) on the procedures and measures insurance intermediaries and insurance undertakings should establish with regard to the management of conflicts of interest that might arise in the course of carrying out insurance distribution activities.

Draft Technical Advice

Against this background, in EIOPA's view, the implementing measures for the amended IMD (being the equivalent to Article 22 of the MiFID Implementing Directive) should be drafted as follows:

Conflicts of interest policy

1. Insurance intermediaries and insurance undertakings should 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 intermediaries 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.

2. The conflicts of interest policy established in accordance with paragraph 1 should 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

[7] http://www.esma.europa.eu/consultation/Consultation-Paper-MiFID-IIMiFIR

interest entailing a risk of adversely affecting 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.

3. Insurance intermediaries or insurance undertaking should design the procedures and measures provided for in paragraph 2(b) to ensure that relevant persons engaged in different business activities involving a conflict of interest of the kind specified in paragraph 2(a) carry on those activities at a level of independence appropriate to the size and activities of the insurance intermediaries or insurance undertaking and of the group to which they belong, and to the materiality of the risk of damage to the interests of customers.

For the purposes of paragraph 2(b), the procedures to be followed and measures to be adopted should include such of the following as are necessary and appropriate for the insurance intermediaries or insurance undertaking to ensure the requisite degree of independence:

(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 the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated by, 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.

If the adoption or the practice of one or more of those measures and procedures does not ensure the requisite degree of independence, insurance intermediaries and insurance undertakings should adopt such alternative or additional measures and procedures, as are necessary and appropriate for those purposes.

4. Insurance intermediaries and insurance undertaking should ensure that disclosure, pursuant to Article 13c (2) of IMD, 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 13b of IMD are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests of the customer will be prevented.

5. Insurance intermediaries and insurance undertaking should make that disclosure to customers, pursuant to Article 13c (2) of IMD, in a durable medium. The disclosure should include sufficient detail, including the risks to the customer that arise as a result of the conflict and the steps undertaken to mitigate these risks, to enable that customer to take an informed decision with respect to the insurance distribution activities in the context of which the conflict of interest arises.

6. Insurance intermediaries and insurance undertakings should 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.

Questions to stakeholders:

Q5: Do you agree that general principles, similar to those set out in Article 22 of the MiFID Implementing Directive, should form the basis for the organisational requirements for insurance undertakings and insurance intermediaries on conflict of interest, further specified through EIOPA guidelines?

Q6: Do you share EIOPA's view that the situations addressed by the organisational requirements in Article 22 (3) may also be relevant in the context of insurance undertakings and/or intermediaries in the course of their distribution activities?

Q7: Do you agree that the amendments proposed in ESMA's Consultation Paper related to periodic reviews of the conflicts of interest policy and disclosure should be the basis for similar requirements for insurance undertakings and insurance intermediaries?

6. Proportionality

Respondents to EIOPA's Discussion Paper were concerned about the administrative burden of the new requirements, especially for small undertakings and sole traders, and urged for a clarification that the principle of proportionality should be applicable to all measures in order to avoid excessive administrative burdens and costs.

EIOPA has thoroughly considered the question whether the principle of proportionality should explicitly be mentioned in the implementing measures for the amended IMD. EIOPA has also scrutinized whether this principle should be specified in more detail with regard to the organisational and administrative measures smaller undertakings and sole traders should take, in order to manage and prevent conflict of interest which arise in the course of carrying out insurance distribution activities (e.g. by providing a non-exhaustive list of examples of how the new rules apply in certain circumstances).

EIOPA takes note of the concerns expressed by the market participants. However, EIOPA is of the opinion that an explicit reference to the principle of proportionality in the implementing measures for the amended IMD would not appear appropriate or necessary. This conclusion is based on the following reasons.

The principle of proportionality is laid down in Article 5(4) of Treaty on the European Union[89]. Furthermore, it is part of the existing Union laws, as it has been translated into the wording of the new IMD provision on conflict of interest:

- Article 13b of the IMD requires insurance intermediaries and insurance undertakings to *"take all **reasonable** steps to prevent conflicts of interest from adversely affecting the interests of their customers"*;

- Article 13c of the IMD requires those persons *"to take **appropriate** steps to identify conflicts of interest that arise in the course of carrying out any distribution activities".*

In the view of EIOPA, these measures ensure that measures adopted must, in practice, be proportionate to the nature, scale and complexity of the risks[10] of consumer detriment related to conflicts of interest inherent in the business of an insurance or reinsurance undertaking or an insurance intermediary. Therefore, a specification of the principle of proportionality, in addition to the measures having to be proportionate to the nature, scale and complexity of the said risks in the legal text of the implementing measures, would not create any added value in legal terms. An elaborate repetition or specification of this principle in the IMD implementing measures rather bears the risk that the application of that general principle becomes unclear or that the objectives of the new provision are not achieved. In this context,

[8] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2010.083.01.0001.01.ENG
[9] *"Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties".*
[10] In line with the wording in Article 29(3), Solvency II

EIOPA would like to clarify that the application of the principle of proportionality must not result in a lower level of protection at the expense of customers.

It should also be considered that the application of the principle of proportionality depends to a great extent on the specific circumstances of each individual case and the nature, scale and complexity of the business models of the insurance intermediaries and insurance undertakings concerned. For example, measures on organisational separation of functions such as 'Chinese walls' may not be required for small intermediaries because of the fact that different functions may be entrusted to only one person, due to the limited number of employees of a small insurance undertaking. This would be even more clearly the case for a sole trader.

EIOPA further thinks that the inclusion of examples in the legal text of the implementing measures would not be appropriate nor would it be able to take account of the diversity of cases which may exist in practice. The potential demand of market participants for further guidance would be better addressed through EIOPA's opinions or guidelines at a later stage. These instruments would be more suitable to clarify the practical application of the concept e.g. by elaborating "good and bad practices" in relation to small intermediaries. This would, in the view of EIOPA, be also of value in promoting convergence and consistency in supervisory practices across Member States.

Instead, in addition, EIOPA proposes to provide further guidance and to enhance convergence in the application of the requirements by issuing Guidelines and or an opinion at a later stage. Besides individual examples, such Guidelines could also provide "good and bad practices", to aid national authorities and market participants in understanding the expectations of EIOPA with regard to the measures to be taken to identify conflicts of interest appropriately. Consequently, EIOPA plans to develop Guidelines on the procedures and measures insurance intermediaries and insurance undertakings should establish with regard to the identification of conflicts of interest that might arise in the course of carrying out insurance distribution activities.

Question to stakeholders:

Q8: Do you agree with the proposal to address questions arising on the practical application of the proportionality principle through further guidance of EIOPA such as opinions or guidelines?

7. Remuneration and Inducements

The Commission's request for advice

EIOPA is invited to consider the existing conflicts of interest framework under the MiFID Implementing Directive and to develop a similar framework for insurance intermediaries and insurance undertakings distributing insurance-based investment products. EIOPA should consider identifying remuneration or commissions arrangements that lead to harm for the customers' interests and ways of avoiding these, or where avoiding these it not possible, examine monitoring, or placing conditions or limitations on conduct that aim to limit harm to the customers' interest.

MiFID Implementing Directive

The MiFID implementing Directive specifies in Article 26, the conditions investment firms have to fulfil when providing, or receiving, a third party payment or non-monetary benefit. The conditions are:

- The existence, nature and amount of the fee, commission or benefit, or, where the amount cannot be ascertained, the method of calculating that amount, must be clearly disclosed to the client, in a manner that is comprehensive, accurate and understandable, prior to the provision of the relevant investment or ancillary service.

- The payment of the fee or commission, or the provision of the non-monetary benefit must be designed to enhance the quality of the relevant service to the client and not impair compliance with the firm's duty to act in the best interests of the client.

Analysis

Third party payments (inducements)

EIOPA shares the opinion that any kind of remuneration or non-monetary benefit provided by a third party ("inducement"), typically give rise to the risk of a conflict of interest. This concerns all kinds of inducements provided by a third party not acting on the behalf of the customer, including (but not exclusively) the different types of commissions paid by insurers, retrocessions in the case of unit-linked contracts, profit-sharing agreements and other (non) monetary benefits.

The conflict of interest is apparent, for instance, where a broker is paid varying commissions by different insurers whose products the intermediary is distributing. A conflict of interest may also arise where the products are from the same insurer, but with different commissions or through a mixture of monetary and non-monetary benefits. With regard to the intermediary's objective of making profit, the intermediary has an interest in distributing products for which he is paid higher charges or where a package of benefits overall offers the strongest return to him. This

interest may conflict with the interest of the customer to invest in products which are the most suitable for him, but for which the intermediary is paid less.

Because of the evident risk of consumer harm, EIOPA believes that it is important to address conflicts of interest, which arise with regard to inducements and to set up specific implementing measures in this regard.

EIOPA believes that the most appropriate way for doing so, would be transferring the general principles of MiFID I to the amended IMD. An alignment with the MiFID I contributes to the objective to build up consistent rules where appropriate, so as to thereby create a level playing field between the different sectors of the financial markets, whilst taking sector specificities into account where relevant.

According to the rules of the MiFID Implementing Directive, which have also been kept as the basis for MiFID II, the payments paid and non-monetary benefits provided by a third party are only permissible if two conditions are met. Firstly, the third party payments and non-monetary benefit must be clearly disclosed to the client. Secondly, the third party payment and the non-monetary benefit must be designed to enhance the quality of service rendered to the customer and does not impair compliance with the firm's duty to act in the best interests of the client.

Disclosure

With regard to the disclosure of inducements, EIOPA shares the opinion of ESMA outlined in its Consultation Paper for MiFID II that it is important that customers are accurately informed about fees, commissions and benefits which a firm receives from third parties. The full disclosure of the payments and of the non-monetary benefits provided by a third party, supports the customer in making an informed investment decision, as well as in assessing the conflict of interest the intermediary is facing.

In general, EIOPA, therefore, believes that equivalent rules as set up under Article 26 (b)(i) of the MiFID Implementing Directive, should be introduced in the drafting of the implementing measures for the amended IMD, too.

It should be noted that ESMA has made detailed proposals in its Consultation Paper for MiFID II on how to enhance investor protection by specifying the details of information firms have to disclose to their clients with regard to third party payments and non-monetary benefits (such as the requirement of periodic disclosure of commissions paid on an ongoing basis). Consequently, it seems reasonable to follow the further ongoing work of ESMA in this respect and to take this into consideration when finalising the Technical Advice for the Commission.

Quality enhancement

EIOPA is conscious that the quality enhancement criterion has raised questions on how it might be applied in practice and that various views have been expressed in response to the MiFID II Consultation Paper on how the criterion might be better

specified. Such measures have impacts for existing market structures and distribution models, depending how this criterion is interpreted and applied in practice.

From EIOPA's viewpoint, the quality enhancement criterion should not have the effect of rendering commission-based distribution models impossible, including for intermediaries solely or mostly dependent on commission for their income. Instead, EIOPA takes the view that the criterion should be understood in the context of ensuring that the steps taken by intermediaries to avoid and manage the conflicts of interest, are able, in practice, to avoid harm to customers.

As an option, a quality enhancement could be assumed where intermediaries are able to show that inducements are used for the benefit of customers, namely, the inducements are used also in the interest of the customers, not only in the intermediary's interest.

Following this approach, the inducements could be used, for example, with regard to:

- The range of services provided (for example, to finance additional services);
- The range of products offered (for example, to offer a broader range of products); and/or
- For the provision of high-quality services to the customers (for example, to finance training of employees).

N.B. The list of examples above is an indicative list only and it is not EIOPA's intention to create a safe harbour provision.

Non-monetary benefits would be permissible if they are beneficial with regard to the services provided to the customers.

From EIOPA's point of view, services for which inducements might be used for enhancement purposes are not limited to the core services of sale of insurance-based investment products and advice in this regard, but comprise all insurance distribution activities such as introducing, proposing or carrying out other work preparatory to the sale or of assisting in the administration and performance of such products. The assessment whether an inducement is used for the benefit of the client is independent from other regulatory requirements to be assessed.

In the view of EIOPA, this approach should not be seen as providing for a simple binary test whereby all commissions or non-monetary benefits are permitted where an intermediary provides a service and funds this through these commissions and benefits. A case-by-case approach should be appropriate, proportional to the nature of the possible conflicts of interest that might arise: for instance, where an intermediary is prepared to accept commissions that are significantly higher for a specific product, the intermediary should also be prepared to prove to their supervisor how the potential heightened conflict of interest this raises is effectively managed and also used in the interest of the customers. Similar reasoning may be considered in relation to substantial non-monetary benefits.

EIOPA is aware that this concept is broad and will raise questions in its practical application. For that reason, EIOPA proposes that further guidance should be elaborated and provided to the market. The most appropriate way for doing so would be through EIOPA's instruments, such as "good and bad practices" to specify EIOPA's expectations.

It should also be noted that the application of the quality enhancement criterion does <u>not</u> affect the obligation of insurance intermediaries and insurance undertakings to act in accordance with the best interest of the customers (Art. 13d of the amended IMD), which is a separate obligation to be fulfilled with regard to the provision and reception of third party payments.

Finally, EIOPA is aware that the ongoing negotiations on the recast Insurance Mediation Directive may lead to new or redefined regulatory requirements with regard to inducements. **EIOPA's intention is <u>not</u> to anticipate, or to impinge on, the final decision to be taken by the European legislator, but to make a proposal for responding to the European Commission's request, in its mandate to EIOPA for Technical Advice, to examine conflicts of interest arising from third party payments**.

Remuneration

Conflicts of interest do not only arise with regard to inducements paid by a third parties to intermediaries, but also with regard to the remuneration paid by insurance undertakings and intermediaries to their employees that are involved in the distribution activities of insurance based investment products.

Respondents to EIOPA's Discussion Paper clearly referred to all types of remuneration models used by insurance undertakings in relations their employees, such as sales bonus, targets and performance measures linked to the variable remuneration of the employees, as possible sources of conflicts of interest.

From EIOPA's point of view, these conflicts of interest are already addressed by the technical advice (as proposed above under Chapter 4), which explicitly refers to a situation where "the insurance intermediary, insurance undertaking, linked person or person involved in carrying out insurance distribution activities has a financial interest relating to those activities".

EIOPA is aware that sectorial legislation such as CRD IV, AIFMD and UCITS V, have established specific requirements with regard to remuneration. This is also the case for MIFID II which was recently adopted by the European legislator.

Against this background, EIOPA believes that further analysis may be needed as to whether additional measures are necessary to achieve broader consistency across

Europe in the way in which conflicts of interest resulting from remuneration of employees involved in distribution activities are handled.

Questions to stakeholders:

Q9: Do you agree that the rules governing conflicts of interest resulting from inducements provided to distributors of insurance based investment products should be aligned with the rules under MiFID I for the sake of a level playing field?

Q10: Do you agree that a conflict of interest arising from inducements provided to distributors might be addressed where these inducements are used for the benefit of the customer?

Q11: From your perspective, which instances might be regarded as being for the benefit of the customer, including in the context of business models which are mostly or purely financed by third party payments?

Q12: In which instances do you think inducements would not be for the benefit of the customer?

8. Investment research

The Commission's request for advice

The Commission has not explicitly invited EIOPA to assess whether the requirements in Articles 24-25 of the MiFID Implementing Directive should also be applied to insurance distribution activities. These provisions entail additional organisational requirements where a firm produces and disseminates investment research.

Analysis

The majority of respondents to the EIOPA's Discussion Paper argued that the additional organisational requirements for investment firms producing and disseminating investment research would not be applicable for insurance undertakings and intermediaries, as these persons would not produce investment research in the meaning of MiFID.

Even if rare cases may not be excluded in theory, EIOPA shares this general observation. Therefore, EIOPA does not believe that the specific organisational requirements which can be found in Articles 24-25 of the MiFID Implementing Directive are of essential importance with regard to the distribution activities of insurance undertakings and intermediaries. Consequently, EIOPA abstains from advising the Commission to implement similar rules in the context of the amended IMD.

This does not mean that organisational requirements would not apply in cases where an insurance undertaking or intermediary exceptionally produces and disseminates investment research; in these cases, the general organisation requirements on how to manage conflicts of interest would apply.

Question to stakeholders:

Q13: Do you share the general observation that insurance undertakings and intermediaries are principally not involved in the production and dissemination of investment research?

9. Annex I: Summary of Questions to Stakeholders

Q1: What would you estimate as the costs and benefits of the possible changes outlined in this Consultation? Where possible, please provide estimates of one-off and ongoing costs of change, in Euros and relative to your turnover as relevant. If you have evidence on potential benefits of the possible changes, please consider both the short and longer term. As far as possible, please link the costs and benefits you identify to the possible changes that would drive these.

Q2: Do you agree that general principles, similar to those set out in Article 21 of the MiFID Implementing Directive, should also be applied to insurance distribution activities, further specified through EIOPA guidelines?

Q3: Do you agree with the adjustments proposed to adapt Article 21 to take into account the specificities of insurance distribution activities?.

Q4: Are there any additional adjustments to be made from your point of view?

Q5: Do you agree that general principles, similar to those set out in Article 22 of the MiFID Implementing Directive, should form the basis for the organisational requirements for insurance undertakings and insurance intermediaries on conflict of interest, further specified through EIOPA guidelines?

Q6: Do you share EIOPA's view that the situations addressed by the organisational requirements in Article 22(3) may also be relevant in the context of insurance undertakings and/or intermediaries in the course of their distribution activities?

Q7: Do you agree that the amendments proposed in ESMA's Consultation Paper related to periodic reviews of the conflicts of interest policy and disclosure should be the basis for similar requirements for insurance undertakings and insurance intermediaries?

Q8: Do you agree with the proposal to address questions arising on the practical application of the proportionality principle through further guidance of EIOPA such as opinions or guidelines?

Q9: Do you agree that the rules governing conflicts of interest resulting from inducements provided to distributors of insurance based investment products should be aligned with the rules under MiFID I for the sake of a level playing field?

Q10: Do you agree that a conflict of interest arising from inducements provided to distributors might be addressed where these inducements are used for the benefit of the customer?

Q11: From your perspective, which instances might be regarded as being for the benefit of the customer, including in the context of business models which are mostly or purely financed by third party payments?

Q12: In which instances do you think inducements would not be for the benefit of the customer?

Q13: Do you share the general observation that insurance undertakings and intermediaries are principally not involved in the production and dissemination of investment research?