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Technical Advice on Conflicts of Interest in direct and intermediated sales of insurance-based investment products

Table of Contents

Executive Summary	3
1. Introduction	3
2. Legal Background	5
3. Appropriate criteria for the identification of conflicts of interest.....	6
3.1. The Commission's request for advice	6
3.2. Analysis	7
3.2.1. Findings.....	7
3.2.2. Assessment and conclusion	7
3.3. Technical advice.....	9
4. Conflicts of interest policy	10
4.1. The Commission's request for advice	10
4.2. Analysis	10
4.2.1. Findings.....	10
4.2.2. Assessment and conclusion	10
4.3. Technical advice.....	12
5. Remuneration and inducements	13
5.1. The Commission's request for advice	13
5.2. Analysis	14
5.2.1. Findings.....	14
5.2.2. Assessment and conclusion	14
6. Proportionality	16
7. Investment Research	17
Annex I: Impact assessment	18

Executive Summary

The European Insurance and Occupational Pensions Authority (hereinafter "EIOPA") received a formal request (mandate)¹ from the Commission on 19 May 2014 to provide technical advice to assist the Commission on the possible content of the delegated acts based upon Article 13c (3) of Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation (hereinafter "IMD")². According to this article the Commission is empowered to adopt delegated acts in order to:

- define the steps that insurance intermediaries or insurance undertakings might be reasonably be expected to identify, prevent, manage and disclose conflicts of interest when carrying out insurance distribution activities;
- establish appropriate criteria for determining the types of conflicts of interest whose existence may damage the interests of customers or potential customers of the insurance intermediary or insurance undertaking.

The Technical Advice which is provided to the Commission takes into account the feedback EIOPA received in response to its Consultation Paper which was published on 1 October 2014. The Technical Advice contains summaries of the responses received, the conclusion EIOPA has taken on its findings and the recommended policy options which should be the basis for the delegated acts to be adopted by the Commission. The Technical Advice entails policy recommendations with regard to the identification of conflicts of interest arising in the course of the distribution of insurance based investment products, and appropriate measures to manage these conflicts of interest. Finally, in addition to the Technical Advice, this paper provides reflections on third party payments (inducements).

For a better understanding EIOPA recommends to read the Technical Advice together with the Consultation Paper published on 1 October 2014 to have a complete picture of the rationale and underlying reasons of EIOPA's policy recommendations.

1. Introduction

On 14 January 2014, the European Parliament and the European Council reached a political agreement with regard to the revision of Directive 2004/39/EC³ (hereinafter "MiFID I"). Subsequent to the political agreement, the final legislative proposals of the new Directive 2014/65/EU⁴ (hereinafter "MiFID II") and Regulation (EU) No 600/2014⁵ 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 and taking into account the timeline of the revision of the IMD, MiFID II

¹ "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

² OJ L 9, 15.1.2003, p. 3.

³ OJ L 145, 30.4.2004, p. 1.

⁴ OJ L 173, 12.6.2014, p. 349.

⁵ OJ L 173, 12.6.2014, p. 84.

also included amendments to the 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”⁶.

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.

EIOPA received a formal request (mandate) 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 cross-sectorial consistency, the Commission has invited EIOPA to consider the existing conflicts of interest framework under Commission Directive 2006/73/EC⁷ (hereinafter “MiFID Implementing Directive”) and to develop a similar framework for insurance intermediaries and insurance undertakings distributing insurance-based investment products. EIOPA was asked to work together with ESMA to achieve as much as consistency as possible in the conduct of business standards for 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 traders⁸. Many respondents also expressed concerns that too

⁶ The amended IMD includes in Article 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.

⁷ OJ L 241, 2.9.2006, p. 26.

⁸ Sole Trader in this context is a natural person, in other words a person who runs a business by himself/herself.

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 prepared a Consultation Paper which presented, in more detail, the recommendations that EIOPA considered including in its Technical Advice to the Commission. Interested parties were invited to comment on these proposals. The consultation period closed on 1 December 2014 and EIOPA received more than 30 responses. Responses which were not designated confidential will be published on EIOPA website. A summary of the feedback to each policy options can be found below.

2. Legal Background

The additional customer protection requirements for insurance intermediaries and insurance undertakings in relation to insurance-based investment products can be found in the new Chapter IIIA of the amended IMD, those in particular with regard to conflicts of interest in Article 13b and Article 13c of this chapter.

"Article 13a - Scope

Subject to the exception in the second subparagraph of Article 2 (3), this Chapter lays down additional requirements on insurance mediation activities and to direct sales carried out by insurance undertakings when they are carried out in relation to the sale of insurance-based investment products. Those activities shall be referred to as insurance distribution activities.

Article 13b - Prevention of conflicts of interest

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 - Conflicts of interests

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.

3. The Commission shall be empowered to adopt by means of delegated acts, in accordance with Article 13f, the following measures:

(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.

Article 13d - General principles and information to customers

1. Member States shall ensure that, when carrying out insurance distribution activities, an insurance intermediary or insurance undertaking acts honestly, fairly and professionally in accordance with the best interests of its customers.

2. All information, including marketing information, addressed by the insurance intermediary or insurance undertaking to customers or potential customers shall be fair, clear and not misleading. Marketing communications shall be clearly identifiable as such.

3. Member States may prohibit the acceptance or receipt of fees, commissions or any monetary benefits paid or provided to insurance intermediaries or insurance undertakings, by any third party or person acting on behalf of a third party in relation to the distribution of insurance-based investment products to customers.

Article 13e - Exercise of delegation

1. The power to adopt a delegated act is conferred on the Commission subject to the conditions laid down in this Article.

2. The power to adopt a delegated act referred to in Article 13c shall be conferred on the Commission for an indeterminate period of time from 2 July 2014.

3. The delegation of powers referred to in Article 13c may be revoked at any time by the European Parliament or by the Council. A decision of revocation shall put an end to the delegation of the power specified in that decision. It shall take effect the day following the publication of the decision in the Official Journal of the European Union or at a later date specified therein. It shall not affect the validity of any delegated acts already in force.

4. As soon as it adopts a delegated act, the Commission shall notify it simultaneously to the European Parliament and to the Council.

5. A delegated act adopted pursuant to Article 13c shall enter into force only if no objection has been expressed either by the European Parliament or the Council within a period of three months of notification of that act to the European Parliament and the Council or if, before the expiry of that period, the European Parliament and the Council have both informed the Commission that they will not object. That period shall be extended by three months at the initiative of the European Parliament or the Council."

3. Appropriate criteria for the identification of conflicts of interest

3.1. The Commission's request for advice

"EIOPA is invited to provide technical advice on the empowerment of the Commission 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."

3.2. Analysis

3.2.1. Findings

The clear majority of respondents agreed that conflicts of interest arise in the context of the distribution of insurance-based investment products and deemed it necessary that insurance intermediaries and insurance undertakings take the appropriate organisational measures and procedures to manage conflicts of interest appropriately.

Many respondents referred to the necessity to harmonise rules across the different financial sectors for the sake of consumer protection and to establish a level playing field for reasons of fair competition. The majority supported EIOPA's proposal to introduce requirements, similar to those set out in Article 21 of the MiFID Implementing Directive, for the insurance sector.

Some respondents argued that the specific situations under Article 21 (a), (b), (c), (d) or (e) would be too abstract and it would not be sufficiently clear what they mean in the retail distribution of insurance-based investment products.

Some respondents criticised with regard to the proposed wording based upon Article 21 (e) of the MiFID Implementing Directive that the deletion of the half sentence "other than the standard commission or fee for that service" would discredit intermediaries accepting commissions in the context of their distribution activities. Furthermore they denied that conflicts of interest would arise in cases where only standard commissions or fees would be paid.

Some respondents were also concerned that the inclusion of entities involved in the development and management of insurance-based investment products would require intermediaries to exercise oversight of insurance undertakings whose products the intermediaries recommend.

Other respondents supported EIOPA's assumption that conflicts of interest would arise with regard to third party payment independent from the question whether the payment would be a standard commission or fee. Some respondents urged to state explicitly that third party payments would be the most important source of conflict of interest arising in the context of the distribution of insurance-based investment products. In addition to the circumstances listed in Article 21 of the MiFID Implementing Directive it was proposed to add excessive sales targets and performance measures as further instances where conflicts of interest typically arise.

3.2.2. Assessment and conclusion

The feedback EIOPA has received from market participants and stakeholders has generally confirmed EIOPA's assumption outlined in the Consultation Paper that the instances described in the provisions are of broad and abstract nature, such that they can be applied very broadly across the different sectors of the financial services.

In view of the responses EIOPA is of the opinion that the wording of Article 21 of the MiFID Implementing Directive should be clarified in order to emphasize that the list of specific instances is non-exhaustive and that other conflicts of interest may occur depending on the individual circumstances and business models of the respective entities.

For that purpose, EIOPA proposed to introduce a general description of the basic elements of a conflict of interest. Additionally, EIOPA considers it appropriate to list instances where conflicts of interest may arise which should provide guidance to insurance undertakings and insurance intermediaries when assessing their individual business models for conflicts of interest.

EIOPA is aware of the fact that the specific situations in Article 21 (a) - (e) of the MiFID Implementing Directive were originally established to address conflicts of interest that primarily arise in the context of investment banking activities. Having in mind the variety of business models and expanding areas of business activities insurance intermediaries and insurance undertakings are pursuing, EIOPA considers the instances listed in Article 21 (a) - (e) of the MiFID Implementing Directive as being of relevance for the insurance sector, too. This is also justified as EIOPA believes that insurance intermediaries and insurance undertakings should take a holistic approach when identifying conflicts of interest. It should be considered that conflicts of interest not only arise at the point of sale, but may also arise during the entire lifetime of a product or duration of an insurance based investment contract.

For example, the situation described in Article 21 (a) of the MiFID Implementing Directive should be taken into consideration in cases where life insurance contracts are terminated prematurely and possibly are resold to other customers. Another example would be that insurance undertakings are interested, because of severe structural changes in the market, to terminate insurance based investment contracts and to replace it with other contracts (e.g. contracts with a guaranteed high interest rate are replaced with contracts with lower interest rates).

As the rationale of Article 21 (b) of the MiFID Implementing Directive is used to describe what a conflict of interest consists of in the first paragraph, from EIOPA point of view there is no need for replication; therefore EIOPA proposes not to replicate Article 21 (b).

EIOPA believes that the situation described in Article 21 (c) of the MiFID Implementing Directive may occur in cases where the policyholder and beneficiary of the insurance based investment contract are not the same person (and the beneficiary like a credit institution providing a mortgage to the customer is of the same group like the insurer). Therefore, this situation should be transferred (now Article 21 (b)).

Regarding Article 21 (d) of the MiFID Implementing Directive many respondents emphasized that this kind of situation would not exist in the insurance sector and would create legal uncertainty if introduced. Against this background EIOPA propose to delete it stressing that the catalogue should comprise situations which may arise in practice, but not only in theory. However, it should be clear that insurance intermediaries and insurance undertakings are required to identify any conflict of interest which arise in the context of their distribution activities, independent from the question whether it is a typical situation or resulting from their very individual business model.

Regarding Article 21 (e) of the MiFID Implementing Directive (now Article 21 (c)), from EIOPA's point of view it is important to state that conflicts of interest may arise from any kind of third party payments, including standards commissions and fees. In this context EIOPA would like to stress that the pure financial interest an entity has in earning a commission or fee leads to a situation in which the interest of the customers

might be adversely affected. This corresponds with the approach CESR (predecessor of ESMA) has taken in the Recommendations regarding Inducements under MiFID which were published in May 2007⁹. There, CESR explicitly came to the conclusion that "the possibility of a receipt of a standard commission or fee is of a nature to give rise to conflicts with the duty owed to clients". The same rationale applies in the insurance sector. This conclusion has to be distinguished from the question which organisational measures or procedures the entities should subsequently take in order to appropriately manage the conflicts of interest.

Regarding the amended Article 21 (d), EIOPA is of the opinion that entities which are involved in the development and management of the insurance-based investment products they distribute should assess whether their involvement gives rise to conflicts of interest with their customers. The intention is not to require the entities to exercise oversight of the manufacturer of the insurance-based investment products, but to assess whether their own involvement leads to conflicts of interest with their customers and if so, how to address these conflicts of interest (e.g. clear separation of responsibilities).

Against this background EIOPA provides the following Technical Advice.

3.3. Technical advice

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 assess whether they, including their managers, employees and tied insurance intermediaries, 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 at the detriment of the customer.

This shall at least be assumed in situations including the following:

- a. the insurance intermediary, insurance undertaking or linked person is likely to make a financial gain, or avoid a financial loss, at the expense of the customer;
- b. the insurance intermediary, insurance undertaking or linked person 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 or linked person 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 involved in the management or development of the insurance based-investment products.

⁹ http://www.esma.europa.eu/system/files/07_228b.pdf

4. Conflicts of interest policy

4.1. 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.

In particular, EIOPA should also consider the existing conflicts of interest framework under Commission Directive 2006/73/EC and to develop a similar framework for insurance intermediaries and insurance undertakings distributing insurance-based investment products."

4.2. Analysis

4.2.1. Findings

Even though the clear majority of respondents shared the view that Article 22 (1) and (2) of the MiFID Implementing Directive would entail general principles also being of relevance for insurance undertakings and insurance intermediaries, respondents had diverging views on the question whether the specific criteria listed in Article 22 (3) thereof could be transferred to the insurance sector.

Some respondents did not support the draft Technical Advice and argued that the circumstances listed in Article 22 (3) of the MiFID Implementing Directive would be designed to address situations common to investment banking activities, but would not be of relevance for the insurance sector. This would raise the question how these criteria should be applied with regard to distribution activities. Respondents expressed their concern about the legal uncertainty which could result from an ambiguous understanding of the requirements the entities would be supposed to fulfil.

Some respondents also stated their preference for a genuine high-level approach which they thought would be more adequate in order to take into account the variety of business models of insurance intermediaries and insurance undertakings.

Respondents also argued that the small intermediaries would not be able to fulfil the requirements as set up in this article in view of their size and limited capacities urging to further elaborate on the principle of proportionality.

Other respondent strongly supported the proposal to introduce equivalent rules as laid down in this article 22 referring to the need of a level playing field and to have the similar level of customer protection across the different financial sectors.

4.2.2. Assessment and conclusion

Taking into consideration the concerns expressed by stakeholders and market participants EIOPA has redrafted the wording of Article 22 (3) of the MiFID Implementing Directive in order to emphasize that the high level principle endorsed in that provision requires insurance undertakings and insurance intermediaries to

implement the appropriate procedures and to adopt the appropriate measure necessary to ensure that the activities are carried out in accordance with the best interest of the customers and are not biased by conflicting interests of the insurance undertaking, the insurance intermediaries or another customer.

EIOPA acknowledges that the specific organisational measures and procedures listed in Article 22 (3) were originally designed to address conflicts of interest arising in the context of investment banking. Nevertheless, EIOPA believes that the measures and procedures are of importance in the insurance sector, too.

From EIOPA's point of view, the restriction of exchange of information as required under Article 22 (3) (a) could be considered between business units concluding distribution agreements with product manufacturer and business units which provide distribution services such as advice to the individual customers (in order to prevent the exchange of information on the commission paid by the insurer for the distribution of its products which may influence the advice provided to the customers). Another example would be the functional separation from distribution units from units which are responsible for complaints handling or the Compliance Function.

A separate supervision as required under Article 22(3) (b) comes into play where persons represent different interests that may conflict, including those of the firm. This is may be the case for employees of the Legal Unit that have to decide (in the entity's interest) whether a customer is entitled for claims.

In EIOPA's view, Article 22(3) (c) comes into play if the remuneration of employees working in the complaints handling unit is linked to the quantitative success of the distribution activities.

In EIOPA's view, Article 22(3) (e) comes into play if the employee providing advice on insurance based investment products would be responsible to decide whether a customer complaint is on solid ground.

EIOPA emphasizes that the list of organisational measures and procedures listed in paragraph 3 of this article is non-exhaustive and is deemed to give guidance to insurance undertakings and insurance intermediaries which organisational measures and procedures should principally be taken into consideration to manage conflicts of interest the entities have identified. Because of the variety of business models this does not mean that the proposed measures and procedures are of relevance for all insurance intermediaries and insurance undertakings and have to be implemented. EIOPA acknowledges that entities may come to the conclusion that the measures and procedures listed in paragraph 3 may not be appropriate, especially for small intermediaries and their limited scope of business, and alternative measures and procedure may be more adequate to manage conflicts of interest efficiently. In EIOPA's view, the crucial point is that the organisational measures and procedures which the individual insurance undertaking or insurance intermediary has chosen ensure that the distribution activities are provided impartially in accordance with the best interest of the customers.

The responses to EIOPA's Consultation Paper have proven that there are uncertainties with regard to the organisational measures and procedures insurance undertakings and insurance intermediaries are supposed to implement to adequately address conflicts of interest arising in the course of distribution activities. The Technical Advice gives guidance in presenting a non-exhaustive list of organisational measures and procedures. Alternative procedures and measures may be taken in consideration. Evolving business models may require new approaches.

Against this background, EIOPA considers it important to be empowered to issue guidelines, if necessary, in order to respond in the future in a flexible way to new

developments or in cases where market participants require more guidance on the application of the general principle.

4.3. Technical advice

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 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.

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 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, 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.

3. For the purpose of paragraph 2(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 customers 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 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 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 customers and are not biased by conflicting interests of the insurance undertakings, the insurance intermediaries or another customer, insurance intermediaries and insurance undertakings must adopt adequate alternative measures and procedures for that purpose.

4. Insurance intermediaries and insurance undertakings should ensure that disclosure, pursuant to Article 13c (2) of Directive 2002/92/EC, 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 thereof 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 Directive 2002/92/EC, 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.

7. Without prejudice to the provisions of this article, EIOPA may develop guidelines in relation to the procedures and measures referred to in paragraph 2. The guidelines should specify the respective risk addressed and explain the appropriateness of the proposed measures or procedures.

5. Remuneration and inducements

5.1. 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."

5.2. Analysis

EIOPA is aware that the general approach of the Council and the report of the European Parliament on the revision of the IMD are addressing the revision of the IMD in its entirety. As the final outcome of the negotiations between the European Parliament and the Council is unclear, EIOPA has decided, in view of the explicit request of the Commission, to provide some provisional recommendations on addressing conflicts of interest arising from third party payments.

EIOPA acknowledges that the recommendations may need some redrafting once a final agreement in the negotiations to revise the IMD has been found. If this should be the case, EIOPA stands ready to support the Commission with further advice.

5.2.1. Findings

Respondents had diverging views with regard to EIOPA's proposal to introduce specific requirements addressing conflicts of interest arising from the receipt of third party payments (inducements).

Most respondents shared EIOPA's opinion that the amendments to the IMD made clear that commission-based distribution models should not be rendered impossible either through an explicit ban or through a de facto ban.

Many respondents from the industry pointed out that a ban of inducement would have severe consequences for many small intermediaries depending on commissions for their income; they stated that a ban on commission could force many entities to give up their business which could consequently lead to less competition and impair services for customers.

Some respondents raised concerns regarding the legal basis for introducing implementing measures on inducements requesting EIOPA to abstain from providing Technical Advice on this specific issue.

Some respondents pointed out that the general approach of the Council in the European legislative procedure to revise the IMD would entail provisions setting legal requirements for the receipt of third party payments. In their view, in contrast to the general approach, the proposed Technical Advice would follow a stricter approach.

Many respondents agreed that third party payments would create a conflict of interest and supported EIOPA's approach.

Many respondents emphasized the need for consistent rules and a level playing field across the different sectors of the financial market and asked to further align the Technical Advice with ESMA's work for the implementing measures for MiFID II to avoid regulatory arbitrage and consumer detriment.

Several respondents also expressed their disappointment that the Technical Advice would only address conflicts of interest resulting from third-party payments, but not address in more detail issues arising vis-à-vis remuneration which is paid to the employees of insurance undertakings or insurance intermediaries, in particular regarding variable remuneration.

Some respondents stressed the view that organisational requirements would not be sufficient to address the conflict of interest resulting from inducements and argued in favour of a ban on inducements.

5.2.2. Assessment and conclusion

EIOPA supports the view expressed by several respondents that in the context of the distribution of insurance-based investment products payments which are provided to an insurance undertaking or insurance intermediary by a third party not acting on

behalf of the customer is a very important source of a potential conflict of interest entailing the risk of customer detriment.

From a consumer protection perspective, EIOPA therefore considers it of utmost importance that specific organisational measures and procedures are introduced in order to appropriately address conflicts of interest resulting from the receipt of third party payments or non-monetary benefits, to ensure strict compliance with the principle of acting in the best interests of the customer.

Regarding the concerns expressed by some respondents with regard to the legal basis and the empowerment of EIOPA to provide recommendations on this, EIOPA would like to emphasize that the Commission has explicitly requested EIOPA in its mandate to elaborate on this specific issue.

EIOPA acknowledges that for investment firms rules on the legitimacy of inducements have already been introduced under MiFID I in 2006 and were subsequently reaffirmed in the legislative procedure for MiFID II, including a relocation of certain implementing measures to Level 1 in order to give them greater force. EIOPA notes that ESMA's Technical Advice on inducements for MiFID II thoroughly builds upon this development and presents a solution, which carefully takes into account the specificities of the market for financial instruments, its participants and own distribution models.

EIOPA notes that similar risks of consumer detriment through conflicts of interest can arise, depending on the market, in the distribution of insurance-based investment products as with financial instruments, such that the an alignment in the basic approaches can be envisaged.

EIOPA notes, however, the predominance in many insurance markets of distribution models where the intermediary relies solely on commissions and non-monetary benefits received from insurance undertakings. In some markets tied-agents are predominant, where such agents will only conduct business for a single insurance undertaking.

EIOPA underlines that the amendments to the IMD exclude measures that would amount to a de facto ban on such business models. EIOPA underlines however that tied-agents operating under such models must ensure, pursuant to the same amendments, necessary steps are taken so they can act in the best interest of the customer.

While EIOPA recognises that similar issues arise also in some markets in relation to the distribution of financial instruments, EIOPA concludes that in further specifying regulatory measures intended for the insurance sector, specific attention might be aimed at clarifying the application of the overarching principles to such business models.

However, given the uncertainty over the upcoming negotiations on the revision of the IMD, EIOPA limits its recommendations at this stage to these general remarks.

From EIOPA's perspective, the proper management of conflicts of interest resulting from third party payments would entail looking at measures in three areas, as also identified by ESMA for the distribution of financial instruments:

- Firstly, measures that the insurance undertaking or intermediary should take to ensure the inducements are for the benefit of the customers and do not lead to detriment for the customer, including the ability to demonstrate this to national competent authorities;
- Secondly, measures to ensure strict compliance with the requirement that inducements do not impair compliance with the insurance undertaking's or

insurance intermediary's duty to act in accordance with the best interest of the customers; and

- Thirdly, measures to ensure the inducements are clearly disclosed to the customer.

EIOPA considers the achievement of a convergent and harmonised approach of great importance, though EIOPA also notes that regulation of distribution in the insurance sector has so far been less harmonised at Union level than distribution of financial instruments. EIOPA recommends therefore measures should be developed to set out a non-exhaustive list of circumstances where inducements can be taken to be for the benefit of the customer. These should be considered also in the context of the different business models in the insurance sector, so as to ensure sufficient clarity for insurance undertakings and intermediaries throughout the EU.

Any list of circumstances would be non-exhaustive, and would need to be carefully calibrated from both a positive perspective (that is, in terms of what it permits) and a negative one (that is, in terms of what it does not permit).

In EIOPA's opinion, it would also be useful to include a definition of "inducement" comprising any monetary or non-monetary benefits (including commissions) insurance undertakings and insurance intermediaries receive or pay in connection with the provision of insurance distribution activities from any party except the customer or a person on behalf of the customer, especially in order to make a clear distinction between inducements (third party payments) and remuneration (internal payments to employees of an insurance undertaking or insurance intermediary). Therefore, remuneration has to be distinguished from inducements and should be addressed separately.

EIOPA considers Article 26 (b) (i) of the MiFID Implementing Directive because of its abstract and high-level nature as appropriate disclosure rule to be transferred to the insurance sector.

EIOPA acknowledges that conflicts of interest may also arise with regard to remuneration paid by insurance undertakings or insurance intermediaries to their employees, which are involved in the distribution activities, especially if the remuneration is variable and based upon quantitative criteria. As EIOPA has pointed out in the Consultation Paper, further analysis is required in this regard in terms of how best to coordinate national approaches to the mitigation of these conflicts. This analysis is already underway.

6. Proportionality

Views of the respondents were split whether the principle of proportionality should be clarified in the implementing measures and whether EIOPA should issue further guidance (such as examples of the practical application) at a later stage, if necessary.

Some respondents stressed the importance of the principle of proportionality, especially with regard to small and midsized intermediaries, and argued in favour of reiterating the principle in the implementing measures for legal certainty.

Some respondents spoke against further guidance by EIOPA arguing that the national regulators would be better placed to assess proportionality taking into account the specificities of the national markets.

Other respondents outlined that the principle of proportionality would be an overall concept applicable to all measures (and already mentioned in Level 1).

Some respondents shared EIOPA's concerns outlined in the Consultation Paper that a reiteration or specification would bear the risk that the application of the general

principle becomes unclear or that the objectives of the new requirements are not achieved.

EIOPA acknowledges the importance of the principle of proportionality, especially with regard to the impact new organisational requirements may have for small and midsize intermediaries. Because of the risk of creating loopholes and ways of circumvention EIOPA strongly rejects the idea of establishing exemptions for predefined market participants or of providing examples showing the minimum standard EIOPA is expecting which would ultimately create a safe harbour for all market participants.

Having taken into considerations the responses to the Consultation Paper EIOPA has modified its Technical Advice on the organisational measures and procedures for the proper management of conflicts of interest (see Chapter 4). Where the proposed specific organisational measures and procedures are not appropriate to manage and prevent conflicts of interest from damaging the interests of the customer, entities must demonstrate that alternative measures or procedures ensure that the distribution activities are carried out in accordance with the best interest of the customers and are not biased by conflicting interests of the insurance undertaking.

7. Investment Research

The responses to EIOPA's Consultation Paper have affirmed EIOPA's assumption that investment research does not belong to the typical business activities insurance undertaking and insurance intermediaries pursue. Therefore, EIOPA does not consider it necessary to introduce specific organisational measures in this regard. Nevertheless, EIOPA would like to emphasize that the general rules on conflicts of interest apply in the unlikely event that insurance undertakings or insurance intermediaries produce investment research. In this case, EIOPA would expect that the entities take into consideration, when defining the organisational measures and procedures required under the general rules, the specific organisational requirements for investment firms which can be found in Article 24 and 25 of the MiFID Implementing Directive as general guidance.

**Impact Assessment
for
EIOPA's Technical Advice
in response to the formal request of the
European Commission
concerning Directive on Insurance
Mediation (2002/92/EC) as amended by
the Directive on Markets in Financial
Instruments (2014/65/EU)**

1. Procedural issues and consultation of interested parties

EIOPA received a formal request (mandate) from the Commission on 19 May 2014 to provide technical advice on a possible Delegated Act concerning Directive 2002/92/EC on Insurance Mediation amended by the Directive on Markets in Financial Instruments repealing Directive 2004/39/EC (Directive 2014/65/EU).

In order to provide market stakeholders with an early orientation on issues that are addressed in the Technical Advice to the Commission and to gather feedback from the market, EIOPA published a Discussion Paper on 21 May 2014.

On 1 October EIOPA published a Consultation Paper giving stakeholders the possibility to comment on EIOPA's considerations how to respond to the Commission's request for Technical Advice. In the Consultation Paper on Conflicts of Interest in direct and intermediated sales of insurance-based investment products, EIOPA raised specific questions related to the impact asking stakeholders, in particular how they would estimate the costs and benefits of the policy proposals presented.

Most respondents pointed out that it would be difficult to assess the exact costs and benefits for different options. However many respondents from the industry were concerned that the policy proposal would have severe impacts, especially for small and medium sized entities. Therefore they strongly advised that special attention should be given to the principle of proportionality and the questions whether the new requirements would not only result in administrative burden, but would also offer tangible benefits for the customers.

They also noted that the real impact may differ from Member State to Member State having in mind that some Member States such as Belgium would have already introduced for the insurance sector equivalent or similar requirements to those in the MiFID Implementing Directive, while others have not. Others pointed out that some insurance undertakings and insurance intermediaries would have, on a voluntary basis, implemented organisational measures and procedures to manage conflict of interest and would be obliged to adapt their internal procedures. Areas where additional costs could be expected would comprise among others, Legal services to assist the implementation of the new rules, Compliance services to monitor the application of the new rules, the establishment of new IT-systems, as well as staff training to educate employees with regard to the new requirements.

In the long term, respondents predicted that the new rules could reduce their revenue streams and in their view could impair competition as in their view fewer competitors would enter the market and while some competitors might exit the business due to increased administrative costs potentially resulting in a reduced choice for consumers. Some respondents also expressed their concerns that financial advice could become unaffordable for many customers if they would be charged (higher) fee as consequence of the additional administrative burden entities would have to bear. . Others pointed out that the cumulative effect of costs of regulation should be considered and referred to parallel legislative procedures such as the ongoing revision of the Insurance Mediation Directive, the PRIIPS Regulations as well as Solvency II.

As benefits for customers respondents mentioned increased transparency which would enable customers to make better informed decisions. Referring to several cases of mis-selling some respondent emphasized that the current legal framework would have failed to sufficiently protect customers, and emphasized the need for more stringent rules. Respondents highlighted the need for harmonized rules from a consumer protection perspective, arguing that the same set of principles should apply for

products which would be substitutable. Aligning the rules would help to mitigate competitive distortions as well as regulatory arbitrage.

2. Problem definition

The revision of the Directive 2004/39/EC of the European Parliament and of the Council on Markets in Financial Instruments (hereafter "MiFID") introduced new amendments to the Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation (hereafter "IMD").

The amendments comprise new organisational requirements for insurance undertakings and insurance intermediaries with regard to conflicts of interests that arise in the context of the distribution of insurance-based investment products. The amended Article 13b IMD requires insurance undertakings and insurance intermediaries to take all reasonable steps to prevent conflicts of interest from adversely affecting the interests of their customers. The amended Article 13c IMD requires insurance undertakings and insurance intermediaries to identify and manage conflicts of interest that arise in the course of carrying out insurance distribution activities. The amended Article 13c (3)(a) and (b) empowers 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.

An equivalent set of rules for investment firms providing investment services in financial instruments has already been introduced through MiFID in 2004. These provisions have been specified by the Directive 2006/73/EC implementing Directive 2004/39/EC of the European Parliament and of the Council as regards the organisational requirements and operating conditions for investment firms (hereafter "MiFID Implementing Directive").

The underlying rationale of the amendments of IMD is that insurance-based investment products are often made available to customers as potential alternatives or substitutes to financial instruments. In order to provide consistent protection for customers and ensure a level playing field between similar products, it is important that the distribution of insurance-based investment products is subject to comparable regulatory requirements. Therefore, the objective pursued by the European legislator is to address the issue of an uneven playing field across the different financial sectors hindering fair competition in the market, as well as to abolish regulatory inconsistencies leading to a patchwork of consumer protection.

As outlined above, the amendments of IMD require insurance undertakings and insurance intermediaries to take all reasonable steps to prevent conflicts of interest from adversely affecting the interests of their customers. This is justified by the fact that conflicts of interest, independent from the question whether they arise in the context of the provision of investment services or the distribution activities of insurance intermediaries and undertakings, raise concerns about consumer detriment. In the case of a conflict of interest, there is the inherent risk that the conflict is inappropriately managed and resolved to the disadvantage of the customer.

The amendments of IMD dealing with conflicts of interest neither specify which criteria should be applied for the identification of conflicts of interest that may arise with regard to the distribution activities of insurance undertakings and insurance intermediaries, nor stipulate organisational measures to be considered for the management of conflicts of interest identified by insurance undertakings and insurance intermediaries.

Different from the regulatory regime under MiFID and its implementing Directive as circumscribed above, the new provisions of IMD, due to their abstract wording, would leave a broad discretion to National Competent Authorities (NCAs) and regulated entities as to how these requirements are applied in practice. This would result in a divergent implementation and application contrary to the objective to foster a level playing field.

In order to avoid regulatory arbitrage and to contribute to a homogenous application of the new organisational requirements for insurance undertakings and insurance intermediaries it is therefore necessary to specify these requirements through implementing measures.

As the data provided by stakeholders in response to the EIOPA's Consultation Paper on Conflicts of Interest is not sufficiently representative to allow a reliable assessment of the quantitative impacts, the following analysis will focus on the qualitative impacts following from the Technical Advice.

With respect to studies mandated by the Commission, which have addressed the question of how the application of the rules of conduct and the organisational requirements of MiFID would impact the insurance sector the following analyses are of particular importance:

- Impact Assessment accompanying the Commission's Proposal to recast the Directive on Markets in Financial Instruments (published on 20 October 2011): http://ec.europa.eu/internal_market/securities/docs/isd/mifid/SEC_2011_1226_en.pdf
- Study on the Costs and Benefits of Potential Changes to Distribution Rules for Insurance Investment Products and other Non-MiFID Packaged Retail Investment Products (published on 29 October 2010): http://ec.europa.eu/internal_market/consultations/docs/2010/prips/costs_benefits_study_en.pdf
- Impact Assessment accompanying the Commission's Proposal to recast the Directive on Insurance Mediation: http://ec.europa.eu/finance/insurance/docs/consumers/mediation/20120703-impact-assessment_en.pdf

Baseline

When analysing the impact of alternative proposed policies, the impact assessment methodology uses a baseline scenario as the basis for comparing policy options. This helps to identify the incremental impact of each policy option considered.

The aim of the baseline scenario is to explain how the current situation would evolve without additional regulatory intervention.

The baseline is based on the current situation of the market, which is considered to be composed of the content of the amended Insurance Mediation Directive and in particular Article 13c IMD.

3. Objective pursued

The empowerment of the Commission to adopt delegated acts to specify the organisational measures insurance undertakings and insurance intermediaries should take in order to identify and manage conflicts of interests was introduced in the

Insurance Mediation Directive (IMD) through Article 91 of Directive 2014/65/EU (MiFID II), which introduced general rules of conducts in relation to insurance-based investment products. The empowerment did not appear in the original legislative proposal by the Commission for the revision of Directive 2004/39/EC (MiFID I), but was only introduced at a later stage of the legislative procedure by way of amendment. Therefore, no indication about the objectives pursued can be found in the original legislative proposal of the Commission.

The Recitals of Directive 2014/65/EU (MiFID II) indicate that the objectives of the legislator are to deliver consistent protection for retail clients and to ensure a level playing field between similar products. Against this background the objectives of the Technical Advice are:

- to encourage consistent application of the organisational measures insurance undertakings and insurance intermediaries should take to manage conflicts of interest that arise in the course of carrying out distribution activities in insurance-based investment products;
- to foster a level playing field regarding the distribution of financial products, which compete with each other and are substitutable from a consumer point of view;
- to enhance consumer protection through provisions addressing conflicts of interest arising in the context of the distribution of insurance-based investment products and potentially creating the risk of consumer detriment.

4. Policy Options

The policy considerations were essentially governed by the Commission's request to achieve as much coherence and consistency as possible between the Technical Advice EIOPA is supposed to provide to the Commission and the regulatory framework under MiFID, especially the organisational requirements to be found in the Implementing Directive of MiFID (2006/73/EC).

In order to meet these predefined specifications, EIOPA's analysis focused on the question whether the requirements of the Implementing Directive of MiFID could be transferred and if so, to which extent modifications would be necessary to meet the specificities of the insurance sector.

For the Technical Advice on the possible content of the delegated acts EIOPA has considered the Policy Options outlined below. The delegated acts the Commission is empowered to adopt pursuant to Article 13c (3) of the Insurance Mediation Directive as amended by MiFID II shall

- 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 distributions activities; and
- 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.

Policy Issue 1: With regard to the Commission's request to establish appropriate criteria for the identification of conflicts of interest

With regard to Commission's request to establish appropriate criteria for the identification of conflicts of interests EIOPA has considered the following options:

- **Policy Option 1:** To implement Article 21 of the MiFID Implementing Directive defining the criteria regulated entities are required to apply for the identification of conflicts of interests.

Article 21 of the MiFID Implementing Directive reads as follows:

"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."

- **Policy Option 2:** To modify Article 21 of the MiFID Implementing Directive in order to mirror two additional instances where EIOPA believes that conflicts of interest may arise (see amendments in letter (c) and letter (d)).

This Policy Option reads as follows:

"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 assess whether they, including their managers, employees and tied insurance intermediaries, 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 at the detriment of the customer.

This shall at least be assumed in situations including the following:

a. the insurance intermediary, insurance undertaking or linked person is likely to make a financial gain, or avoid a financial loss, at the expense of the customer;

b. the insurance intermediary, insurance undertaking or linked person 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 or linked person 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 involved in the management or development of the insurance-based investment products."

Policy Issue 2: With regard to the Commission's request to define steps insurance undertakings and insurance intermediaries should take to manage conflicts of interest.

With regard to Commission's request to specify the organisational measures insurance undertakings and insurance intermediaries should take in order to manage conflicts of interest EIOPA has considered the following options:

- **Policy Option 1:** To introduce the general principle of Article 22 of the MiFID Implementing Directive obliging insurance undertakings and insurance intermediaries to establish an effective conflicts of interest policy in writing in order to ensure that the relevant activities are provided at an appropriate level of independence without specifying concrete organisational measures undertakings should consider for that purpose.
- **Policy Option 2:** To implement Article 22 of the Implementing Directive specifying the organisational measures and procedures regulated entities should take to manage conflicts of interest.

Article 22 of the MiFID implementing Directive reads as follows (wording would have to be aligned to the insurance vocabulary, e.g. "client" has been replaced by "customer"):

"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”.

- **Policy Option 3:** To modify Article 22 of the MiFID Implementing Directive in order to allow insurance undertakings and insurance intermediaries to demonstrate that alternative measures and procedures are appropriate to ensure that the distribution activities are carried out in accordance with the best interest of the customers and are not biased by conflicting interests.

This Policy Option reads as follows:

"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 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, 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.

3. For the purpose of paragraph 2(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 customers and are not biased by conflicting interests of the insurance undertaking, the insurance intermediaries 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 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 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 customers and are not biased by conflicting interests of the insurance undertaking, the insurance intermediaries or another customer, insurance intermediaries and insurance undertakings must adopt adequate alternative measures and procedures for that purpose.

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.

7. Without prejudice to the provisions of this article, EIOPA may develop guidelines in relation to the procedures and measures referred to in paragraph 2. The guidelines should specify the respective risk addressed as well explain the appropriateness of the proposed measures or procedures."

5. Analysis of Impacts

Impacts of Policy Options outlined in Chapter 4.

As the Policy Options with regard to the Policy Issue 1 and Policy Issue 2 outlined in Chapter 4 are closely linked and complementary to each other, it is appropriate and necessary to analyse their impacts all together. This is supported by the fact that the respective Policy Options differ only slightly and the following analysis focus on the qualitative aspects, only.

Benefits

For insurance undertakings and insurance intermediaries, the Policy Options with regard to Policy Issues 1 and 2 as outlined in Chapter 4 could provide the following benefits:

- Enhanced corporate governance: The Policy Proposal will enhance corporate governance mechanisms by which regulated entities are controlled and directed.
- Prevention of customer detriment and legal actions: The Policy Proposal will lower the risk of consumer detriment resulting from an improper management of conflict of interests and consequently lower the risk that costumers take legal action because of damages suffered.
- Increased customer confidence and decreased reputational risks: As outlined, the Policy Proposal will lower the risk of consumer detriment which simultaneously increase the customers' confidence and decrease reputational risks.
- Prevention of Regulatory arbitrage: Harmonised rules ensure equal treatment of entities located in different Member States (regulatory arbitrage with regards of entities of different origin) as well as alike treatment of entities distributing products different with regard to legal nature and regulation (cross sectorial regulatory arbitrage).

For customers, the Policy Options with regard to Policy Issues 1 and 2 as outlined in Chapter 4 could provide the following benefits:

- Enhanced consumer protection: The Policy Proposal aims to ensure that insurance undertakings and insurance intermediaries provide their services in the best

interest of their customers and conflicts of interest are not improperly resolved, to the detriment of the customer.

- Counterbalance to the customer's paucity of information: The Policy Proposal aims to counterbalance the customer's paucity of information since customers do not generally have the full picture of the extent to which insurance undertakings and insurance intermediaries are facing conflicts of interest.

For National Competent Authorities, the Policy Options with regard to Policy Issues 1 and 2 as outlined in Chapter 4 could provide the following benefits:

- Enhanced legal certainty: Implementing measures facilitate the application and understanding of Level 1 - requirements

Costs

For insurance undertakings and insurance intermediaries, the Policy Options with regard to Policy Issues 1 and 2 as outlined in Chapter 4 could involve the following costs:

- One-off costs as insurance undertakings and insurance intermediaries are required to take organisational and procedural measures for implementation (e.g. costs associated with project management and/or engagement with external consultants, the identification of conflicts of interest, the development or revision of conflicts of interest policies, the introduction of new IT systems, staff training).
- Ongoing costs as insurance undertakings and insurance intermediaries are required to periodically review and adapt their organisational measures and procedures, if necessary (including the periodic identification of conflicts of interest and revision of conflicts of interest policies, if necessary).

For customers, the Policy Options with regard to Policy Issues 1 and 2 as outlined in Chapter 4 could involve the following costs:

- Additional costs insurance undertakings and insurance intermediaries have to bear in order to implement the new regulatory requirements may be transferred to the customers rendering services and products more expensive.

For NCAs, the Policy Options with regard to Policy Issues 1 and 2 as outlined in Chapter 4 could involve the following costs:

- The need to supervise and enforce new rules.

Comparison of Options

- **Policy issue 1:**

With regard to **Option 1** and **Option 2** EIOPA considers it generally appropriate to make recourse to Article 21 of the MiFID Implementing Directive and to transfer its principles in order to define appropriate criteria for the identification of conflicts of interest that may arise in the course of carrying out insurance distribution activities.

Even though the wording in 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 Article 21 (a) – (e) MiFID Implementing Directive are also relevant for insurance intermediaries and insurance undertakings in the course of carrying out insurance distribution activities.

Nevertheless, EIOPA is of the opinion that Article 21 should be modified in order to address the following issues.

Firstly, a general circumscription of conflict of interest should be introduced to facilitate the understanding and application of the provision. This clarifies that the specific instances listed in letter (a) - (d) are only of exemplary nature and insurance undertakings and insurance intermediaries should focus on the general question whether they pursue interests which are distinct from the customers' interests and which have the potential to influence the services rendered at the detriment of the customer.

Secondly, it should be clarified that conflicts of interest may also arise if the distributors are involved in the development or management of products. For example, conflicts of interest 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.

Thirdly, it should be clarified that conflicts of interest 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.

Against this background, **Option 2** seems to offer the preferable solution from EIOPA's point of view.

The aligned wording reads as follows:

"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 assess whether they, including their managers, employees and tied insurance intermediaries, 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 at the detriment of the customer.

This shall at least be assumed in situations including the following:

a. the insurance intermediary, insurance undertaking or linked person is likely to make a financial gain, or avoid a financial loss, at the expense of the customer;

b. the insurance intermediary, insurance undertaking or linked person 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 or linked person 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 involved in the management or development of the insurance-based-investment products."

- **Policy Issue 2:**

Option 1 would offer insurance undertakings and insurance intermediaries a broad discretion and flexibility how to implement the organisational requirements. In addition to that, **Option 2** would require the entities to consider whether a catalogue of proposed measures [see Article 22 (3) of the MiFID Implementing Directive] is necessary and appropriate in order to manage conflicts of interest properly and ensure the prerequisite independence. EIOPA believes that the measures of Article 22 (3) do not only apply for investment firms, but have also a particular relevance to manage conflicts of interest arising in the context of the insurance distribution activities; for example "measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries ... services or activities" may play a role in the relationship between a sales manager and employees advising customers with regard to insurance-based investment products.

If the entities come to the conclusion and can demonstrate that the proposed measures and procedures are not appropriate, the entities are entitled, under **Option 3**, to adopt alternative measures to ensure that the services provided are not biased by conflicting interests of those entities. From EIOPA's perspective **Option 3** therefore offers the most appropriate solution.