

The insurance distribution directive and its consequences for the Luxembourg life insurance industry

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Directive (EU) 2016/97 on Insurance Distribution of 20 January 2016 ("IDD" or "the Directive") harmonises national provisions concerning the distribution of insurance and reinsurance products and insurance-based investment products ("IBIPs") by insurance intermediaries, insurance companies, their employees, and ancillary insurance intermediaries in the European Union.

The objective of the present article is not to summarize the general European legislation, but more specifically to draw out areas of special interest for the leading Luxembourg industry; i.e. insurance companies and brokerage firms active in the field of wealth insurance.

The implementation of the European Directive and the application of corresponding Delegated Regulations has been postponed to 1 October 2018. The European Parliament substantiated this request for postponement by the need to give insurance undertakings and insurance distributors more time to better prepare for a correct and effective implementation of the Directive and to implement the necessary technical and organisational changes to comply with the Delegated Regulations.

The aims and potential consequences of this overwhelming EU legislation on the insurance sector have been already presented and commented by many authors.

Clearly and because good balance between sustainable profits, i.e. remuneration schemes, in the first place, and monitored liabilities in the second place, is key for success, many authors have already commented on the first concern, i.e. the remuneration of distributions networks and the corresponding changes to be introduced.

Remuneration framework – IDD v. MiFID II (for memory)

Unlike Directive MiFID II which considerably restricts the possibility for firms providing the

service of investment advice on an independent basis and the service of portfolio management to accept and retain fees, commissions or any monetary and non-monetary benefits from third parties, and particularly from issuers or product providers; IDD generally accepts such remuneration in connection with the distribution of an “insurance-based investment product” as long as the payment of fees, commissions or any non-monetary benefit does not have a detrimental impact on the quality of the relevant service and does not impair the distributor’s duty to act honestly, fairly and professionally in accordance with the customer’s best interests.

Distributors’ liabilities – Life insurance – Specific Luxembourg focus

The specificity of the Luxembourg insurance industry not only pertains to the **variety of distributors** (*‘bancassurance’* entities combining investments services, investment and insurance products, EEA banking institutions having created insurance brokerage units aiming at performing EU-wide services, asset management companies or wealth management advisers cumulatively licensed as insurance brokers, standalone brokerage firms, etc.) but also to the large portion of unit-linked/ **investment- based life insurance products** and finally to the international (at least Europe wide) type of business which is conducted under the **Freedom to provide services regime** (“FPS”).

3 major legal changes introduced by IDD will therefore need to be carefully considered and anticipated by the local insurance industry:

- **Scope of distributors – Dual responsibilities**

The first impact of IDD directly follows from the new definition of so called “distributors”. This term deliberately differs from the reference to the sole “intermediaries” mentioned in the previous Directive 2002/92/EC. ‘Insurance distributor’ means any insurance intermediary, ancillary insurance intermediary and insurance undertaking. Distributors, encompassing a large variety of persons or institutions (including the traditional agents, brokers and *‘bancassurance’* operators, insurance companies) will be subject to ‘equality of treatment’ (i.e. same level of duties, obligations and liabilities) considered necessary to ensure customer protection.

In short, anybody involved with insurance distribution (especially advising on, proposing, carrying out preparatory work to the conclusion of insurance or concluding insurance contracts) falls within the scope of IDD.

This level playing field is considered a guarantee for customers to benefit from the same level of protection.

In practice it may lead to situations of co-liability among the various types of distributors at stake (see the example of the customer receiving pre-contractual information and advice from the insurance broker and the insurance company’s employee: who is fulfilling the duty to inform?) where national legislations had operated a ‘clear’ cut in terms of liability before.

Beyond the respective obligations laid down in Regulation (EU) 2017/2358 with regard to the terms of the collaboration agreement between the insurance intermediary and the insurance company, distribution agreements should be carefully reviewed on both sides (intermediary and insurance company) in order to precisely clarify their respective role, anticipate potential risk scenarios and achieve a good balance, especially as to their respective liability.

Luxembourg's core market is the distribution of insurance products "linked to investment funds". The Directive classifies this specific category as insurance-based investment products and underlines the importance to align their distribution with MiFID II (Directive 2014/65/EU).

- **Insurance-based investment products: the greater challenges**

On top of PRIIP's Regulation EU/1286/2014, the distribution of insurance-based products generates a full range of additional obligations for the distributors:

✓ **Specific professional and organisational** requirements must be abided by (art. 10, IDD).

Buying an insurance-based investment product implies a risk and investors should be able to rely on the information and quality assessment provided. Insurance intermediaries and insurance undertakings that advise on, or sell, insurance-based investment products to retail customers are to possess an **appropriate level of knowledge and competence** in relation to the products offered and their employees should be given adequate time and resources to be able to exhaustively inform the customers.

✓ **Specific information standards** (art. 29 & art. 30 of IDD and Regulation (EU) 2017/2358) aimed at addressing the investment embedded in insurance-based investment products shall apply and include provision of appropriate information, and requirements for advice to be suitable.

✓ **Restrictions on remuneration** (art. 28 & art. 29 of IDD and Regulation (EU) 2017/2359) apply. The payment of remuneration (fee, commission, non-monetary benefits) in connection with the distribution of insurance-based investment products should not have a detrimental impact on the quality of the relevant service. In order to fulfil this condition satisfactorily the distributor should develop, adopt and regularly review policies and procedures relating to conflict of interests and ensure that the customer is adequately informed about fees, commissions or benefits. When advice is provided to the customer (Luxembourg anticipated rule according to draft Law n° 7215 and art. 295-10 of the Law in the Insurance Sector (*'loi du 7 décembre 2015 sur le Secteur des Assurances'*) is that any distributor shall provide advice to a policyholder habitually residing in Luxembourg), the information on (1) all costs and related charges must be disclosed as well as (2) information relating to the distribution of the product, (3) including the cost of advice!

Surely, the main feature of Luxembourg's leading insurance industry resides in its international character and the passporting activities throughout the EU.

- **Impact of international activities (FPS)**

For the first time - and if one may note, for a matter of change -, IDD specifies in a very clear manner at several places that the stricter requirements of a Member State have also to be complied with by insurance intermediaries operating under the freedom to provide services.

So far under the regime of Directive 2002/92/EC there is no clarity about the national law governing the duty to inform or advise the client living abroad when the insurance intermediary is active from his home country through FPS.

Even though consumer protection rules would logically imply that local general good provisions must be followed by a foreign insurance intermediary, this principle was never completely confirmed either by the Directive itself nor European case-law from the European Court of Justice.

Times are changing!

Intermediaries will need to particularly focus on these national rules in the context of the information provided to policyholders, i.e. in respect of advice given and disclosure of remuneration schemes.

For example: a Luxembourg based insurance broker will necessarily have to analyse and adapt the information given to the policyholder, depending on the specific national law governing the situation. The mere observance of Luxembourg pre-contractual information rules will definitely not suffice.

Interestingly enough, in the context of “national law governing the situation”, IDD considers that stricter national provisions of the customer’s habitual residence are the relevant ones. According to IDD (article 22 (2)), the provision of advice is mandatory if the customer’s country of habitual residence so foresees.

This may create inconsistent legal situations and requires anticipation measures by the stakeholders as Directive Solvency 2 (see article 178 ‘Applicable law’) expressly refers to the alternative provided for in Regulation Rome I, namely the possibility for the policyholder to opt for the law of his nationality.

Distributors will need to rethink their subscription process and decide upon the risk management options (advice: yes/no and how) in case, e.g. a French national who is habitually residing in Belgium, wishes to conclude a contract governed by French law (law of his nationality) rather than Belgian law (law of his habitual residence). An illustration of potential difficult situations can be found in the Belgian draft Bill for IDD’s implementation. In fact, it indicates that “whenever advice is given, personalised recommendation is due”. Advice is therefore not made compulsory.

Neighbouring countries such as France, Luxembourg, Germany and Belgium have thus taken or are about to take different positions in terms of the compulsory or facultative character of the duty to provide advice prior to the conclusion of the insurance contract.

CONCLUSION

The international character of the Luxembourg Life industry has an important impact on the preparatory work to the implementation of IDD:

The Directive aims at a so-called *minimum harmonisation* and for the first time in the EU legislative framework, insurance intermediaries, are **expressly** reminded of their obligation to **follow the stricter requirements of their policyholders' country of residence**. In practice, a Luxembourg insurance brokerage entity which would conduct business on an opportunistic approach and accept clients residing in various countries (e.g. 1 per year in Luxembourg, 20 in France, 5 in Spain, 2 in Sweden, 2 in the UK, etc.) will surely need to anticipate this aspect.

These stricter national rules will notably impact pre-contractual information duties, the type of advice to be given, the product documentation, authorised remuneration schemes and in particular the incentives gathered from underlying investment vehicles.

Insurance intermediaries and employees of insurance undertakings will also need to comply with **continuing professional training and development requirements** (including knowledge of financial risks, of the insurance market, of applicable laws governing the distribution of insurance products such as consumer protection law and relevant tax law, of assessing customer needs, etc.).

No doubt that the implementation may appear wide and burdensome, but it is a **unique opportunity** for all entities involved to (re-)negotiate distribution agreements (especially brokerage agreements, but also financial agreements such as asset management agreements) in order to achieve a **good balance of liabilities between the professionals involved**, review risk management options and look for sustainable business alternatives.

The Regulations supplementing the Directive do not involve transposition measures. The automatic result is that distributors will necessarily have to directly abide by their scope of obligations as early as 1 October 2018.

This, at least, leaves the door open for maximum harmonisation of operational processes and adequate internal and external advice!

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