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EIOPA's Preparatory Guidelines on Product Oversight and Governance Arrangements by Insurance Undertakings and Insurance Distributors in the Context of Polish Recommendations on Product Management

Product oversight and governance arrangements play a key role in customer protection. For many years the design of insurance products has not ensured meeting the needs of the target market and avoidance of mis-selling. They are an essential element of the new regulatory requirements under the Insurance Distribution Directive. Because of their relevance in terms of customer protection, it is of utmost importance that the new requirements are properly implemented and applied. As a part of consumer protection, it is the obligation of insurers to provide distributors with adequate information on the insurance product. This is an important step forward as new insurance products are extremely complex not only from the consumers' perspective, but also at the distribution point.

Key words: EIOPA, consumer protection, soft law, product management.

1. Introduction

In June 2016 The European Insurance and Occupational Pensions Authority (EIOPA) issued the Preparatory Guidelines on Product Oversight and Governance arrangements for manufacturers and distributors of insurance products in all the official languages of the European Union. The scope of the preparatory Guidelines has been extended (comparing to the original draft) and apart from provisions dedicated to manufacturers of insurance products (Chapter 1), they now include provisions for distributors of such products (Chapter 2).

EIOPA's Guidelines are a non-binding instrument addressed to national competent authorities or financial institutions. Pursuant to Article 9(2) and Article 16 of the Regulation (EU) No 1094/2010¹ EIOPA is issuing Preparatory Guidelines addressed to competent authorities on how to proceed in the preparatory period leading up to the transposition of Directive (EU) 2016/97 on in-

¹ Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority, OJ L 331, 15.12.2010, p. 48.

insurance distribution² and the application of the delegated acts envisaged thereafter. The guidelines are designed to ensure the common, uniform and consistent application of European Union law, but they cannot add requirements to the European legal texts they are based upon. The Preparatory Guidelines were issued for the purpose of establishing consistent, efficient and effective supervisory practices with regard to product oversight and governance arrangements as outlined in Article 25 of the 2016/97 Directive. Their aim is also to ensure common, uniform and consistent application of the Union law as well as to establish consistent, efficient and effective supervisory practices drafted by EIOPA. Therefore, EIOPA's Guidelines are an important document with regards to the interpretation of the Insurance Distribution Directive.

The Guidelines cover arrangements that generally apply to all insurance undertakings and all other insurance distributors, including any natural or legal person pursuing the activity of insurance distribution, regardless of the fact whether these activities are pursued as a principal professional activity or on an ancillary basis, by an independent broker or by a tied agent, provided that they fall within the scope of the Insurance Distribution Directive.

As a non-binding instrument, EIOPA's guidelines are considered to be "soft-law"³ and therefore no obligation arises to include in the competence of National Authorities a power to issue recommendations⁴. However, pursuant to Article 16 of Regulation (EU) No 1094/2010, the competent authorities and financial institutions shall make every effort to comply with those guidelines. The Polish Act on Insurance and Reinsurance⁵ states grounds for the Polish Financial Supervision Authority – Komisja Nadzoru Finansowego – to issue documents aimed at the implementation of EIOPA's guidelines.

As presented in the document, due to its nature it is not the intention of the Guidelines to necessitate enforcement action by competent authorities if they become aware of practices which are not fully in line with the Guidelines. The Authorities should discuss with market participants possible ways for appropriate remedial actions⁶. This means that although the Guidelines are focused on supervision authorities, intermediaries should also be aware of the regulations provided there to avoid practices that may be questioned by the supervision authority.

² Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution, OJL 26, 2.2.2016, p. 19.

³ About the soft law regulations in the financial market: A. Chłopecki, „Zakres, sposób i skutki stosowania „miękkiego prawa” jako alternatywy dla regulacji ustawowych – na przykładzie rynku finansowego”, *Wiadomości Ubezpieczeniowe* 2013, no. 3 (special edition), pp. 33–40.

⁴ Same opinion: D. Maśniak, „Wpływ rekomendacji KNF na ustalenie przez ubezpieczycieli wysokości zadośćuczynienia z tytułu szkody komunikacyjnej”, *Prawo Asekuracyjne* 1/2017 (90), pp 28–48.

⁵ Act of September 11, 2015 on Insurance and Reinsurance Activity, OJL 2015, item 1844 with amendments, Art. 365 point 1.

⁶ Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and insurance distributors, 18 March 2016, EIOPA-BoS-16-071, p. 2.

The aim of this article is to present the justification for issuing the Guidelines by the European Supervision Authority and to compare the rules provided therein with the Recommendation on product management by insurers issued by Komisja Nadzoru Finansowego⁷ on March 22nd, 2016. As Poland is still in the early implementation phase it is worth referring to the basic assumptions of the new regulations to assess their adequacy with the European expectations.

2. Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and insurance distributors – main objectives

The objective of the Guidelines is to provide early guidance and to support national competent authorities and market participants (including intermediaries) in the implementation of the Product Oversight and Governance requirements as laid down in the Insurance Distribution Directive. The Guidelines aim to further minimize the risks of consumer detriment and mis-selling of insurance products. They intend to provide direction for the dialogue between supervisors and the industry on the necessary cultural change in this area. It ought to be emphasized that consumer protection is the top issue not only as the basis for the Guidelines, but also for EIOPA's actions⁸. The main objective of the European Supervisor is the protection of policy holders and beneficiaries⁹ and the Guidelines may be interpreted as one of the remedies to prevent mis-selling that occurred in Europe over the last years.

Moreover, the objectives of the Guidelines are meant to enhance consumer protection by strengthening the controls before a product is launched at the producer level (insurer) and then minimize the risk of products and services being proposed to the public that could lead to consumer detriment. In that sense, the Guidelines refer to the provisions of Insurance Distribution Directive obliging insurance undertakings as well as intermediaries manufacturing any insurance product for sale to maintain, operate and review a process for the approval of each insurance product, or significant adaptations of an existing insurance product, before it is marketed or distributed to customers. The product approval process shall specify an identified target market of customers for each product and ensure that all relevant risks are assessed, the intended distribution strategy is consistent with the identified target market and to take reasonable steps to guarantee that the insurance product is distributed to this identified target market¹⁰.

⁷ The Polish Financial Supervision Authority.

⁸ See also: M. Więcko-Tułowicka, "The Role of European Insurance and Occupational Pensions Authority in the Formation of Consumer Protection in Insurance Contracts", *Prawo Asekuracyjne* 3 (92) 2017, pp. 57–67.

⁹ Article 27 of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), OJ L 335, 17.12.2009.

¹⁰ Article 25 of Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution, OJ L 26, 2.2.2016.

As insurance products are often sold by financial institutions other than insurance companies themselves, therefore the design of the product might not be the only cause of mis-selling. EIOPA so far has provided no study or impact assessment indicating a particular need for detailed guideline requirements for non-life insurance products (e.g. motor, home) or certain pure risk insurance products. However, its' supervisory experience has proved that consumer detriment may also occur with regard to non-life products¹¹. Most problems have been caused by unit-linked insurance so far¹². It should be emphasized that the ultimate responsibility to ensure proper advice and need-based selling lies with the distributor. Under the Insurance Distribution Directive the term "distributor" also includes insurers distributing insurance products directly. The product oversight and governance by insurance undertakings is able to support these efforts by the distributors but can neither substitute for them nor be made fully responsible for any distributor. Under the Insurance Distribution Directive, where advice is offered prior to the conclusion of a contract, distributors must provide customers with a personalised recommendation explaining why a particular product best meets customer's demands and needs. It is possible only if manufacturers provide customers with sufficient information to enable them to understand and place the product properly with the target market.

3. Prevention of conflicts of interests. Inducements

The problem of conflict of interests has been analyzed by EIOPA for the last years in details. In general, the conflicts of interest occur when an entity has an interest of its own that conflicts with the interest or interests of other customers or entities for whom the entity is also acting in some capacity. Conflicts of interest can exist without harm for the customer, for instance where a conflict is identified and managed or mitigated by the entity suffering the conflict so as to ensure there is no harm for the customer. Some conflicts of interest relate to conflicts between the interests of different groups or types of customers, for instance between existing customers and new customers, or customers for different product classes (who may drive different levels of remuneration for the seller). Conflicts of interest are not limited to the pre-contractual phase of a contractual relationship, but may also relate to issues that arise following a contractual commitment¹³.

A lot of effortes have been undertaken to solve conflicts of interest related to Packaged Retail and Insurance-based Investment Products (PRIIPs)¹⁴ by the three predecessors to the European Supervisory Agencies, namely the Com-

¹¹ Final Report on Public Consultation on Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and insurance distributors, EIOPA, March 18, 2016, p.62.

¹² See: EIOPA's Report on thematic review on monetary incentives and remuneration between providers of asset management services and insurance undertakings, April 26, 2017.

¹³ Discussion Paper. Conflicts of interests in direct and intermediated sales of insurance-based investments products (PRIIPs), pp.10–11.

¹⁴ Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs), OJ L 352, 9.12.2014, pp.1–23.

mittee of European Insurance and Occupational Pension Supervisors (CEIOPS), the Committee of European Banking Supervisors (CEBS) and the Committee of European Securities Regulators (CESR), (collectively known as the three level three committees or 3L3)¹⁵. Their work formed a basis for the proposals of the European Commission, and included a specific section on possible future 'level two' measures on conflicts of interest.

The Guidelines are referring to this problem, as well. It is requested that manufacturers implement arrangements providing proper management of conflicts of interest and make sure that the interest and objectives of consumers are taken into account when designing insurance products. Therefore, the product oversight and governance arrangements should aim to prevent and mitigate customer detriment, support a proper management of conflicts of interests and should ensure that the objectives, interests and characteristics of customers are duly taken into account (Guideline 2). The product distribution arrangements should aim to prevent and mitigate customer detriment, support a proper management of conflicts of interests and should ensure that the objectives, interests and characteristics of customers are duly taken into account (Guideline 14). What is important – in the context of distributors – is that the product distribution arrangements should aim to ensure that the distributor obtains all other necessary information on the product from the manufacturer in order to fulfill its regulatory obligations towards the customers (Guideline 17). This includes information on the main characteristics of the product, its risks and costs as well as circumstances which may cause a conflict of interests to the detriment of the customer.

In that meaning, all organizational arrangements should prevent and manage conflicts of interests which may arise between distributors and their customers (e.g. inappropriate sales incentives). EIOPA points out that the explicit reference to the proper management of conflicts of interest aims to clarify that they may also arise at the stage of developing new insurance products and that the undertakings should take the appropriate measures and establish the appropriate procedures to manage these conflicts accordingly¹⁶.

There is still no detailed specification of the circumstances under which inducements, namely third party payments, such as commissions paid by manufacturers to distributors in connection with the distribution of Insurance-Based Investment Products (IBIPs), have a detrimental impact on the quality of service provided to the customer. What has been defined so far is that a "detrimental impact" on the quality of the relevant service to the customer will exist when the inducement is of such a nature and scale that it provides an incentive to carry out insurance distribution activities in a way which is not in ac-

¹⁵ http://eiopa.europa.eu/fileadmin/tx_dam/files/publications/submissionstotheec/20101012-3L3-TF-Report-on-PRIPs.pdf, pp. 39–40.

¹⁶ Final Report on Public Consultation on Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and insurance distributors, EIOPA, March 18, 2016, p.9.

cordance with the best interests of the customer¹⁷. It is worth highlighting that EIOPA does not have an intention of prohibiting the receipt of inducements.

4. Distribution of insurance products

The Guidelines oblige the manufacturer to select with appropriate care only such distribution channels that are appropriate for the target market considering the particular characteristics of the product (Guideline 10). The manufacturer is obliged to provide distributor with detailed information about the product that is of adequate standard, clear, precise and up-to-date. The information given to distributors should be sufficient to enable them to understand and place the product properly on the target market and also to identify the target market for which the product is designed as well as to identify the group of customers for whom the product is considered unlikely to meet their interests, objectives and characteristics. This information helps the distributor to select the insurance products to distribute and to assess which customers to advertise and promote the individual insurance products to.

The manufacturer should also regularly examine whether the product is distributed to customers belonging to the relevant target market and to take remedial actions in case a distribution channel does not meet this requirement. The purpose of this guideline is to ensure that the distributor receives all product related information the distributor is required to provide to the customers pursuant to the information requirements and conduct of business rules of the Insurance Distribution Directive.

As the product distribution arrangements are an important element to prevent and minimize detriment to the customers, EIOPA has decided that distributors regularly review whether their arrangements are still valid and up to date. This applies, in particular, to the distribution strategy for each insurance product taking into consideration that the target market (as initially identified by the manufacturer) may be redefined in the course of time due to external factors (such as market developments).

5. Polish Recommendations on product management

Based on the EIOPA Guidelines, the Polish Financial Supervision Authority – Komisja Nadzoru Finansowego issued a Recommendation on product management by insurers on March 22nd, 2016¹⁸. This document sets forth basic frames for a proper organization of product management systems as well as the identification, measurement, monitoring and reporting of risks related to such a process. The recommendation obliges insurers' Management Boards and Boards of Directors to implement and supervise the product management procedures, which should be revised each year to update in case of non-compliance.

¹⁷ EIOPA Technical Advice on possible delegated acts concerning the Insurance Distribution Directive, February 1, 2017, EIOPA-17/048, p. 123.

¹⁸ Available in Polish at: https://www.knf.gov.pl/knf/pl/komponenty/img/Rekomendacje_system_zarzadzania_produktem_22-03-2016_46359.pdf

The Polish Recommendation document –as well as EIOPA’s Guidelines – compels insurers to create and present to the market only products with features, risks, insurance protection, fees and distribution channels that are adequate to the needs of the target market group. Before establishing the product, insurers are obliged to conduct its detailed analysis. This obligation also applies while outsourcing the product creation process. An interesting provision of the Recommendation (no. 27) is to register defects of insurance products and also to report systemic product defects to the Supervision Authority.

The Polish Recommendation reflects EIOPA’s obligation to prevent and manage conflicts of interests which may arise between distributors and their customers. This includes the implementation of employee and distributor remuneration rules in compliance with the Polish legislation as well as with the recommendations of the supervision authority.

The Polish Recommendation goes beyond EIOPA’s Guidelines obliging insurers to conduct proper claims’ handling process, including resolution of complaints. In case of a dispute, insurer should seek compromise and amicable settlement.. The insurer is also obliged to adopt procedures aimed at analyzing conclusions on claims management process with regard to the product management – including product design.

A separate set of rules on adequacy of insurance products was published together with the first Recommendation¹⁹ with obligations of Management Board and Board of Directors to implement rules on providing adequacy of insurance products. It is worth noting that this Recommendation applies to group insurance that for many years has been problematic in Poland²⁰.

The EIOPA’s Guidelines have been focused not only on insurers themselves, but also intermediaries. This element of product management seems to be missing in the Polish Recommendation. Contrary to the European perspective, the Polish Financial Supervision Authority seems to put insurers responsibility first and to minimize responsibilities of distributors. Although insurers create insurance products, it is the responsibility of distributors to provide them to an adequate target market.

6. Conclusions

Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and insurance distributors have been introduced to improve industry’s reputation and obtain higher customer trust. The aim is also to make insurance undertakings put the clients’ characteristics, objectives and interests first. Furthermore, the Guidelines are focused on providing support and guidance to competent authorities in their preparatory steps leading

¹⁹ Available in Polish at: https://www.knf.gov.pl/knf/pl/komponenty/img/Rekomendacje_adekw_prod_22-03-2016_46358.pdf

²⁰ Detailed information on group-insurance problems in Poland: M. Więcko-Tułowicka, *Monitor Ubezpieczeniowy* no. 55, pp. 20–23, “Ubezpieczenia grupowe z perspektywy konsumenta”, see also: M. Orlicki, „Pozycja prawna banku w ubezpieczeniach bancassurance”, *Prawo Asekuracyjne* 2008, no. 2, p. 67.

to a consistent implementation of the organizational requirements on the Insurance Distribution Directive's product oversight and governance arrangements at an early stage. This resulted in introducing the detailed Recommendations in Poland.

The rules provided for in the Guidelines enable insurance undertakings to mitigate the risk of different approaches at the national level of IDD implementation and to avoid the need for further alignment for a matter of consistency among Member States. It is worth noting that despite the fact that the Guidelines are preparatory in their nature, the interpretation of terms such as "conflict of interest", "consumer detriment" or "target market" will be used in the execution of provisions of the Insurance Distribution Directive in the next years. The work and the knowledge obtained from the document itself, consultation papers and analyses reflect the view of EIOPA's demand for the change in insurers' actions in all Member States.

The Polish Recommendations are a good example of compliance with EIOPA's demands. The documents provided by the Polish Supervisor do not limit the obligations of insurers in product management process and even go beyond what is expected at the European supervisory level. It is a fair transposition of European rules reflecting the role of EIOPA's Guidelines. However, it is the compliance with these rules that is going to be mostly supervised in the coming years. No actions of the Polish Supervision Authority have been reported following the Recommendations so far. Due to the fact Insurance Distribution Directive is in force, verification of insurers' procedures is the next step to come.

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Wstępne wytyczne Europejskiego Urzędu Nadzoru Ubezpieczeń i Pracowniczych Programów Emerytalnych dotyczące ustaleń w zakresie nadzoru nad produktem i zarządzania nim przez zakłady ubezpieczeń i dystrybutorów ubezpieczeń w kontekście polskich wytycznych dotyczących zarządzania produktem

Wstępne wytyczne dotyczące ustaleń w zakresie nadzoru nad produktem i zarządzania nim pomiędzy zakładami ubezpieczeń a dystrybutorami ubezpieczeń są istotnym elementem ochrony konsumenta. Przez wiele lat tworzenie produktów ubezpieczeniowych nie zapewniało klientom odpowiedniej ochrony przed przypadkami tzw. mis-sellingu oraz oferowania produktów nieadekwatnych do potrzeb konsumentów. Zarządzanie i nadzór nad produktami ubezpieczeniowymi to również element nowej polityki dystrybucji ubezpieczeń określonej w tzw. Dyrektywie IDD. Ze względu na tę doniosłość bardzo ważne jest, aby nowe regulacje zostały implementowane prawidłowo we wszystkich państwach członkowskich.

Jednym z elementów ochrony konsumenta jest obowiązek ubezpieczyciela przekazania pośrednikowi adekwatnych informacji w zakresie produktu ubezpieczeniowego. Jest to ważny krok biorąc pod uwagę fakt, iż nowe produkty ubezpieczeniowe są niezwykle skomplikowane nie tylko z perspektywy konsumenta, ale również oferującego je pośrednika ubezpieczeniowego.

Słowa kluczowe: EIOPA, ochrona konsumenta, miękkie prawo, zarządzanie produktem.