Annex to response to EC consultation on suitability and appropriateness: Aspects of insurance markets and features of insurance-based investment products overlooked by the EC targeted consultation

The regulatory framework for IBIPs is different

- Insurance distribution is regulated by the **Insurance Distribution Directive** (2016/97/EU "IDD"), not by MiFID. The IDD, which has been applied across the EU since 1 October 2018, provides the legal framework for the sale of all insurance products. It aims to increase consumer protection when buying insurance and to create a level playing field among insurance producers and distributors. This new legal framework is working well and has provided important improvements in consumer protection. The IDD introduced strong and effective conduct rules for the sale of all insurance products, with additional, enhanced requirements for the sale of insurance-based investment products (IBIPs).

- The IDD is a **minimum harmonisation directive**, which sets out minimum common standards. In reality, many member states have opted to introduce more stringent rules. This minimum harmonisation approach was deliberate, as it enables the EU to set the same high standard for all distribution systems, while allowing national regulators to tailor national rules to meet the needs and expectations of their local consumers. Any new initiative can only be successful if it respects this well-functioning legislative framework. The level of granularity proposed by the consultation, however, does not do this.

- Insurers are also subject to **Solvency II**. This has specific implications for the application of the proposed framework. In terms of asset allocation, Solvency II does not allow insurers free choice themselves, meaning it is impossible for insurers to offer a completely free choice of asset allocation to consumers. This has not been considered in the consultation paper. IBIPs' assets are held by the insurance company. The insurer needs to find the best balance between the individual client's needs and the collective interest of the wider pool of policyholders in terms of the claims-paying capacity and its Solvency II position. A legally rooted balance between conduct of business regulation and prudential regulation is absolutely essential for maintaining healthy insurance companies and healthy markets. Both perspectives must be taken into account and this justifies a "per product" approach for IBIPs.

- Under the IDD, the suitability assessment sits alongside the **demands and needs test**. This additional assessment of whether a product meets the needs of the consumer is unique to insurance and an additional step in the sales process of both advised and non-advised sales of all insurance products. The consultation has not considered how any new regime will interact with the demands and needs test.

The insurance distribution system is different

- There is **no single EU distribution system for insurance**, instead there are 27 diverse national markets. Each national system has its own specific features based on the needs and expectations of local consumers. Any new initiatives appliable to insurance must take this diversity into account and work equally well in all markets.

- In many markets, insurance distribution still relies in a large part on **face-to-face advised sales**. These sales are carried out by small distributors (often sole-traders or microenterprises employing

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two or three people). These advisers often operate in specific local areas, where there would otherwise be limited access to advice. They typically provide advice on a range of insurance products across several product lines. They are insurance experts not investment experts. While they can provide high quality advice on products offered by insurers, they are unlikely to have the skills and expertise to also offer advice on other investment products (especially those offered by third parties) as seems to be envisaged in the consultation. The implications of this have not been considered, nor have the implications for training and registration requirements for advisers.

- Some EU markets have a legal requirement to provide advice prior to the sale of an IBIP. **Mandatory advice** is usually financed through commission. The consultation paper does not appear to consider how the new regime would be applied in markets with mandatory advice. In particular, no consideration is given to how this new service would be financed, where advice is usually financed through commission.

- In many markets, **execution-only sales of IBIPs do not exist** and the online distribution of IBIPs is also very limited. In these markets, it is unclear what purpose the new regime would serve and how it would benefit consumers.

IBIPs have different features

- **IBIPs are not simply investment products** with an insurance wrapper. They are fundamentally different and offer specific features. This fact has not been given due consideration in the proposed new regime, rendering it useless for IBIPs.

- **IBIPs can be designed and structured in many different ways**. Insurers offer a wide range of IBIPs that combine investment with unique features such as insurance cover, guarantees or capital protection mechanisms, flexibility of payments, estate benefits etc. Such elements can be designed and structured in many different ways to offer a diversified choice to consumers and better adapt to their needs. For example, the current definition of IBIPs includes unit-linked products, profit-participation products, hybrid products, certain annuities and national-specific products classified as packaged retail and insurance-based investment products (PRIIPs), such as certain funeral products. All these products can have different types and levels of guarantees at maturity, be linear or structured, static or dynamic (for example in the case of hybrids) and in many cases allow consumers to choose between different underlying investment options (MOPs). The difficulties in applying the standardised approach pursued in the Key Information Document (KID) for all PRIIPs has already demonstrated the impossibility of applying a single standard to all these products.

- **Many IBIPs offer a guarantee to investors.** These guarantees can be constructed in a variety of ways, each offering different protections and benefits to consumers. This existence (or not) of a guarantee is just as important in matching a product to the risk appetite of a consumer as the risk profile of the underlying assets. The proposed regime, however, gives this no consideration. Guaranteed products also include elements invested directly in the insurer's general account, without assets directly attributable to each individual client. The use of the general account is crucial to financing these guarantees. How these assets would be treated is also given no consideration in the consultation paper.

- **Many IBIPs offer additional insurance cover.** This is just as important to the consumer in choosing an IBIP as the criteria (risk, return, legal restrictions etc) included in the consultation paper. Not only do insurance customers choose whether or not they are looking for a product that includes a specific cover, they may also wish to differentiate between products based on the specific scope and features of the cover offered. For example, IBIPs might offer biometric risk cover against death, disability, sickness, unemployment etc.

- **IBIPs have a different duration to other investment products**. The holding period of IBIPs is defined *ex ante* and covers a medium- to long-term time horizon. They are not intended to be bought often or switched regularly. Consumers only realise the benefits of the product they have chosen if they hold it to maturity.

- **Many insurance products are hybrid products.** These products offer an investment element via a "unit-linked" component and additional protection via a traditional insurance component. These products offer many additional benefits to consumers but are not even mentioned in the consultation paper. Dynamic hybrids offer additional protection through life-cycling. This involves the automatic shift of client assets from riskier to less risky assets throughout the life of the product, enabling consumers to benefit from a balance between growth and protection. There is no way to integrate this mechanism into the proposals in the consultation paper.

Insurance customers have different needs

- Insurance customers typically have a **longer-term investment horizon**. The purchase of an IBIP is often part of a customer's long-term financial planning and is seen as an investment in their financial future. IBIPs are often bought alongside other insurance products (including non-life products).

- **Switching during the lifetime of a product is much less common for IBIPs** as the implications for the insurance features, as well as the investment component, must be considered. Extensive switching is unlikely to be to the consumer's benefit (bringing with it, for example, cancellation costs, lower guaranteed interest rates or poorer biometric parameters due to changed entry age or health status). Actively encouraging switching is therefore not advisable.