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THE EU REGULATORY FRAMEWORK ON BANCASSURANCE: WORK IN PROGRESS ON WHAT?

Abstract

The ongoing process to amend the EU Directive on insurance mediation is an opportunity to address certain issues that have arisen with respect to so-called bancassurance operators. The essay wants to expose these issues, compare with what has been found in EU documents suggesting possible solutions or highlighting gaps that require further investigation.

Key words: bancassurance, intermediaries, tied agents, disclosure, conflict of interest.

According to Whereas n. 9 of the Directive 2002/92/EC on insurance mediation (hereinafter: IMD), various types of persons or institutions, such as agents, brokers and "bancassurance" operators, can distribute insurance products because equality of treatment between operators and customer protection requires that all these persons or institutions be covered by the IMD.

Under this principle bancassurance operators have the right to have access to insurance mediation by acquiring the status of insurance intermediaries like other "full time" operators such as agents and brokers. In this way, the IMD exceeds the resistance to the eligibility of such operators as insurance intermediaries, which had emerged in several Member States under the previous Directive 77/92/EEC.

Therefore, Member States cannot reasonably be prevented these operators from carrying out the

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insurance mediation as defined in the IMD, nor prohibit pursuing this activity in their territories to operators established in other Member States.

The IMD, however, gives no definition of "bancassurance operators" in accordance with the decision to focus the definition of "insurance intermediary" without providing definitions of various categories of intermediaries. Therefore these operators are defined differently by each Member State, which may include or exclude certain financial intermediaries. Although the IMD requires all natural or legal persons who carry out insurance mediation to its rules except for specific exclusions, domestic legislations may always exclude some of them the ability to carry it out.

Moreover, IMD allows to bancassurance operators to gain a "dual" capacity because they add to their typical activities (e.g. banking, investment services) insurance mediation. Under this dual capacity, these operators might pursue the insurance mediation abroad by way of establishment or provision of services, without carrying out their typical activities in the host Member State. This possibility, however, may be excluded if an operator is not permitted by the EU law or its own domestic law to pursuing its main activity in other States.

From the foregoing, IMD allows bancassurance operators as defined by the Member States to pursue the insurance mediation fulfilling the rules laid down by the Directive.

Because these operators carry out a principal professional activity other than insurance, professional qualifications required might be different from the other "full time" intermediaries. According to Article 4 of the IMD, home Member States may adjust the required conditions with regard to knowledge and ability in line with the activity of insurance mediation and the products distributed, particularly if the principal professional activity of the intermediary is other than insurance mediation. In such cases, that intermediary may pursue an activity of insurance mediation only if an insurance intermediary fulfilling the conditions of that Article or an insurance undertaking assumes full responsibility for his actions.

Unlike professional requirements, the IMD makes no distinction between intermediaries from the requirements information to customers. Therefo-

re, Articles 12 and 13 shall apply also with respect to bancassurance operators.

The regulatory framework described above shows that agents, brokers and "bancassurance" operators should receive equal treatment by the Member States. Professional qualifications required of bancassurance operators could be more loose than "full time" intermediaries, while requirements information to customers is the same.

Such a regulatory framework could be explained as follows with regards to bancassurance operators. Possible differences in the professional qualifications are justified because these operators are already subject to the rules of their own core business (e.g. banking, investment services), while the requirements information are the same because the same are the relationships that can arise with customers by bancassurance operators and "full time" intermediaries.

Both of these explanations do not fully persuade.

With regard to professional qualifications, employees of the bancassurance operators know the products related to the principal professional activity carried out. Therefore, they may know the characteristics of those life insurance products in which the component of financial investment is prevalent on the insurance, but their knowledge could not exist if compared with non-life insurance products. Undoubtedly, the bancassurance channel has grown by distributing life insurance products. However, the emerging trend is to use this distribution channel also for non-life products. If equality of treatment between intermediaries requires that bancassurance operators be covered by the IMD, customer protection needs of skilled professionals in all various classes of insurance in which they operate. When the insurance offer is moving away from investment products, professional qualifications must be the same for all intermediaries. Therefore, the above-mentioned provision of Article 4 of IMD on intermediaries whose principal professional activity is other than insurance mediation should be not applied to bancassurance operators.

In addition, these operators are sometime the controlling shareholders of the insurers whose products they distribute, while other times they are among the main shareholders. Therefore, it might be a little useful to provide that they may pursue an activity of insurance mediation, if an insurance undertaking assumes full

responsibility for his actions. It would be like saying that these operators are responsible for themselves because the deterrent effect of insurer's responsibility which requires the control of the insurer on the intermediary - is likely to disappear or fade.

The conclusion is that upcoming amendments to IMD should be ruled out that the professional qualifications of bancassurance operators are different because their principal activity is other than insurance.

With reference to requirements information, the principle of equal treatment between "full time" intermediaries and those of bancassurance assumes that all such intermediaries are able to establish the same relationship with the customer, i.e. that the latter has no other dealings with intermediaries outside of insurance.

However, a bank which acts as an insurance intermediary may also grant a loan and distribute an insurance coverage for the risk that affects the ability of the borrower/policyholder to repay the loan to the bank, or the guarantee provided to the bank.

In these cases the bank may require the customer to purchase the insurance product, making the granting of credit for that purchase. Moreover, the bank could also be a direct beneficiary of the insurance benefit arising under the coverage distributed in this way. Does this scenario bring out conflicts of interest for the bank? Does bank share this conflict with the other insurance intermediaries?

IMD doesn't provide answers to these questions because a rule is missing on the conflict of interest.

Whereas n. 19 states that IMD should specify the obligations which insurance intermediaries should have in providing information to customers, while Article 12 lays down a list of such information which is only functional to make known whether the insurance intermediary has a holding, direct or indirect, representing more than 10 % of the voting rights or of the capital in the insurance undertaking, or vice versa.

However, a Member State may in this area maintain or adopt more stringent provisions which may be imposed on insurance intermediaries independently of their place of residence where they are pursuing mediation activities on its territory provided that any such more stringent provisions comply with Community law. Therefore a conflict of interest rule is left to each Member State, so that such regulation is only possible and may differ within the European Union.

The lack of a conflict of interest rule applies to all insurance intermediaries, not only the bancassurance operators. The forthcoming amendments to IMD probably also introduce harmonized rules on conflict of interest.

The Consultation document on the Review of the Insurance Mediation Directive (IMD) prepared by the Commission Staff points out that, from one hand, one of the objectives of the revision of the IMD should be to adopt clear and effective rules on conflicts of interests and transparency which affect the distribution of all insurance products, so that insurance intermediaries should be obliged to act honestly, professionally and in line with the interests of their customers. From the other hand, another objective of the revision of the IMD should be to establish a more robust EU disclosure framework which should lead to a higher degree of harmonisation.

This is certainly welcome and necessary to achieve an effective Single market.

However, those just reported are conflicts that seem specific to bancassurance operators. The new IMD should take them into account by providing a rule that can neutralize even these specific conflicts. Unfortunately, the above Consultation document does not mention anything about such conflicts. It "only" states that conflict of interests can arise both in the relationship between a broker and an insurance company and between a broker and third parties, such as asset managers. Therefore such conflicts of interests may compromise the objectivity of the advice given to customers. Considering the fact that these sellers are often engaged in the provision of advice or other personalised services, these conflicts of interests can have a direct impact on the quality of the service, leading to policy holders buying unsuitable and overpriced products and leading also to less competitive markets.

The analysis provided by the Commission Staff is acceptable. However, failure to address the specific conditions related to the position of the bank to clients may be in conflict with the objective of ensuring a level playing field for all intermediaries, as well as being detrimental to their clients.

The conflict of interest noted above does not exhaust the critical issues arising from bancassurance operators. As far as transparency is concerned, the current IMD does not contain any provisions on remuneration and Member States are therefore free to

impose their own remuneration requirements on sellers of insurance products.

On the suggestion of the investigation initiated by the State of New York Public Prosecutor Elliot Spitzer, the debate on the eligibility of contingent commissions has also begun in Europe. EU Commission issued a Sector Inquiry on business insurance in 2007 where this aspect has been examined limited to brokers, to conclude that the solutions adopted in this regard in the Markets in Financial Instruments Directive (hereinafter: MiFID) are a benchmark for future amendments to the IMD.

The Consultation document of the Commission Staff suggests that the application of the high level principles concerning conflicts of interest and transparency both to insurance intermediaries and insurance undertakings could be considered. In this context, one option could be to use the MiFID Level 1 regime as a starting point for the management of conflicts of interest, notably with regard to remuneration. In view of the Commission Staff, the sophisticated MiFID regime for the identification, management and disclosure of conflicts of interest provides undertakings with some flexibility to determine the appropriate approach for their business, depending on its nature, size and complexity.¹

¹ Here is Article 18 of MiFID level 1 related to the conflicts of interest.

1. Member States shall require investment firms to take all reasonable steps to identify conflicts of interest between themselves, including their managers, employees and tied agents, or any person directly or indirectly linked to them by control and their clients or between one client and another that arise in the course of providing any investment and ancillary services, or combinations thereof.
2. Where organisational or administrative arrangements made by the investment firm in accordance with Article 13(3) to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to client interests will be prevented, the investment firm shall clearly disclose the general nature and/or sources of conflicts of interest to the client before undertaking business on its behalf.
3. In order to take account of technical developments on financial markets and to ensure uniform application of paragraphs 1 and 2, the Commission shall adopt, in accordance with the procedure referred to in Article 64(2), implementing measures to:
 - (a) define the steps that investment firms might reasonably be expected to take to identify, prevent, manage and/or disclose conflicts of interest when providing various investment and ancillary services and combinations thereof;

The solutions provided by the MiFID, however, don't seem totally helpful compared to the bancassurance operators. These intermediaries, in fact, are often in a "tied" relationship with respect to insurers because they hold controlling shares in their capital or vice versa.² This could lead to the conclusion that a such distribution channel is "owned" by the insurer, so resulting in a failure to apply rules based on incentives paid to intermediaries by third parties as is set by MiFID, at least in the interpretation given by the former committee CESR. The goal of leveling the playing field between insurance intermediaries and to protect clients can be reached taking into account also that the incentives paid to "proprietary" networks, including bancassurance operators, may have the same effect on the independence of their advice of those paid by or to third parties. Therefore, the upcoming amendments to the IMD, as the MiFID should not neglect this issue.

Finally, reference to the solutions adopted by MiFID for the future regulation of the insurance mediation suggests paying attention to the following three questions: the investments packaged as life insurance policies, the definition of client and the outsourcing. They concern above all the bancassurance operators, although in principle also for other insurance intermediaries.

With regard to the first question, bancassurance operators have historically been used as a distribution channel for life insurance products in which the financial investment was most prevalent.

According to Article 12, par. 3 of the IMD, prior to the conclusion of any specific contract, the insurance intermediary shall at least specify, in particular on the basis of information provided by the customer, the demands and the needs of that customer as well as

(b) establish appropriate criteria for determining the types of conflict of interest whose existence may damage the interests of the clients or potential clients of the investment firm".

² According to Article 2 n. 25) of MiFID level I, "Tied agent" means a natural or legal person who, under the full and unconditional responsibility of only one investment firm on whose behalf it acts, promotes investment and/or ancillary services to clients or prospective clients, receives and transmits instructions or orders from the client in respect of investment services or financial instruments, places financial instruments and/or provides advice to clients or prospective clients in respect of those financial instruments or services.

the underlying reasons for any advice given to the customer on a given insurance product. These details shall be modulated according to the complexity of the insurance contract being proposed.

The Consultation document noted above considers that this provision does not deal adequately with the risk that insurance intermediaries doesn't act honestly, fairly and professionally in accordance with the best interests of their clients, when they are distributing investments packaged as life insurance policies.

In view of the Commission Staff, in the context of tied agents, the responsibility to act in the best interest of the client would remain with the insurance undertaking. It's unclear, however, if bancassurance operators are considered as a tied agents when they are part of the same group (financial conglomerate) of the insurer, while responsibility likely to be little useful for as mentioned above.

Moreover, amendments to IMD need to ensure that the client receives information as regards the remuneration of the sellers, making clear the difference between the premium paid and the actual invested part of the premium. The Consultation document adds that remuneration structures should not be such that they materially impact on the ability of the intermediary to act in the best interest of the client and should be structured in a way that effectively avoid or manage any conflicts of interest that may arise. These statements are acceptable. However, remuneration may not be the only factor that influences the bancassurance operator, especially if it acts within a financial conglomerate which includes the insurer.

It's also acceptable the other statement of the Consultation document. When providing investment advice for investments packaged as life insurance policies, the insurance intermediary should obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, his financial situation and his investment objectives. This information should be obtained so as to enable the firm to recommend to the client or potential client the investment services and financial instruments that are suitable for that client or potential client. However, there is also a need for extra warning when such policies are sold by banks. This is because customers don't often realise that they buy insurance together with the investment, and they rely on the fact that the bank would safeguard their interests.

The issue related to the information is strictly connected to the second question arising from the reference to MiFID, i.e. the definition of client.

IMD doesn't provide a definition of client. Whereas n. 21 states that there is less of a need to require that such information be disclosed when the customer is a company seeking reinsurance or insurance cover for commercial and industrial risks, while Article 12 par. 4 says that the information requirements referred to in the previous paragraphs need not be given when the insurance intermediary mediates in the insurance of large risks, nor in the case of mediation by reinsurance intermediaries. Therefore IMD makes a distinction taking into account the type of risk faced by a person (large risks v. mass risks), instead of the kind of person or the purposes for which a person may seek insurance coverage.

Otherwise, MiFID introduces a classification of clients in three categories of investors - retail, professional and counterparties - according to their experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs, and the clients classified as retailers may apply to be considered as professional, and vice versa, as provided in Annex II to MiFID.

The two Directives have adopted different criteria to classify clients and MiFID allows mobility between retail and professional investors, unlike the IMD compared to policyholders. In addition, both Directives do not distinguish between clients and consumers. However, Directive 2002/65/EC concerning the distance marketing of consumer financial services covers both insurance products and investment services that are offered to the consumer, which is defined as any natural person who, in distance contracts covered by this Directive, is acting for purposes which are outside his trade, business or profession.

Therefore, it would be highly desirable that the EU Commission should consider whether these distinctions are still useful or are they also to be harmonized (i.e. coordinates).

The last question raised by the reference to MiFID concerns the regulation of the outsourcing. IMD doesn't provide any rule related to it, so his eligibility as its discipline is left to each Member State for all insurance intermediaries. An exception might perhaps be considered the situation envisaged by Article 4, par. 4, which regulates the inability of the in-

surance intermediary to transfer the premium to the insurance undertaking or to transfer the amount of claim or return premium to the insured, where such activities are carried out by a broker.

However, a bancassurance operator is also subject to MiFID, which allows outsourcing and requires that outsourcing of important operational functions may not be undertaken in such a way as to impair materially the quality of its internal control and the ability of the supervisor to monitor the firm's compliance with all obligations (see Article 13 par.5). In addition, Directive 2009/138/EC (so called Solvency II), provides a definition of outsourcing³ and regulates the use by insurers, while the above-mentioned Directive 2002/65/EC makes a distinction between "supplier", who is the contractual provider of services subject to distance contracts, and "supplier of a means of distance communication", which means any public or private, natural or legal person whose trade, business or profession involves making one or more means of distance communication available to suppliers.

Equal treatment between intermediaries and the need for clear rules and conforming to the principle of proportionality seems to require the Commission to propose amendments to the IMD on this profile.

SUMMARY

The analysis should have highlighted some shortcomings in the current European Union rules on operators of bancassurance. Equal treatment between insurance intermediaries cannot be reached on detriment of the protection of their clients. The leveling of the playing field cannot operate for the exclusive benefit of the bancassurance operators, but requires that they have adequate skills. The reference to MiFID repeatedly expressed by the EU Commission must also be functional to coordinate certain Community provisions, but cannot be uncritically extended to the whole insurance industry.

³ Article 13 n 28): "outsourcing" means an arrangement of any form between an insurance or reinsurance undertaking and a service provider, whether a supervised entity or not, by which that service provider performs a process, a service or an activity, whether directly or by sub-outsourcing, which would otherwise be performed by the insurance or reinsurance undertaking itself.