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20 October 2017

Dear Robert,

**AFM Response to FCA consultation CP17/23, Insurance Distribution Directive, Implementation Paper 2**

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:
  - comment on the proposals, and highlight the need for further clarity in the way FCA intends to implement the proposals in the UK.
2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not for profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 30 million people in the UK and Ireland, collect annual premium income of £16.4 billion, and employ nearly 30,000 staff<sup>1</sup>.
3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses<sup>2</sup>.
4. In addition, the Bank of England and Financial Services Act 2016 now provides an additional Diversity clause for FiSMA, to require the PRA and

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<sup>1</sup> ICMIF, <http://www.icmif.org/global-mutual-market-share-2013>

<sup>2</sup> Financial Services Act 2012, section 138 K: <http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted>

FCA to take account of corporate diversity and the mutual business model in all aspects of their work<sup>3</sup>.

5. We responded to FCA's first consultation on IDD implementation, commenting on the very short timescales for firms to respond and act on FCA proposals, and calling for the regulator to be pragmatic in its expectations of firms in the first few months of the Directive taking effect. The first consultation dealt with the high level principles of the Directive, which- as we confirmed in response- are not significantly different from the current regime in the UK.
6. We did though suggest the more detailed content of the subsequent consultation paper(s) merely reinforced that the timescales are very difficult to work to, particularly for the small firms that AFM represents. FCA has concluded it was necessary to provide an interim consultation (this one), and we appreciate the opportunity this presents to clarify certain information, whilst both FCA and industry seek to prepare for implementation of IDD with less than full information.
7. In our response to CP17/07 we also asked FCA to ensure that in subsequent consultations, it clarified the requirements for CPD record-keeping for ex-employees. The recently issued PS17/21 did not address this query, so we repeat here the need for clarity.
8. FCA will be aware of the recommendation by ECON to postpone the date from which the IDD should apply until 1 October. FCA is well-aware of the challenges of delivering the new regime- with the final rules as yet unpublished- to the currently, impossibly tight timescale, and we encourage them and the UK government to actively support proposals to delay implementation.
9. Our responses to specific questions raised in the consultation are attached below. We would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'AB' followed by a long horizontal stroke and a vertical stroke at the end.

Chief Executive  
Association of Financial Mutuals

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<sup>3</sup> <http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted>

## Our responses to specific questions raised in the consultation

*Q1: Do you agree with our proposals to amend COBS to implement the conduct of business requirements in Chapter V of the IDD?*

We agree with the proposal to implement IDD chapter V proposals into COBS. We make comments about the specific nature of implementation against relevant questions below.

*Q2: Do you agree with our proposals to implement the IDD information disclosure obligations? Where possible, please distinguish between the minimum directive requirements and areas where we have exercised discretion.*

We agree with the approach, including that FCA retains those requirements that exceed the minimum expected of the IDD, as indicated in paragraph 5.13. Whilst FCA has asked for specific comments on areas where it has exercised discretion, it has not specified these in the text on paragraph 5.13. It would have been helpful for FCA to summarise those differences to encourage feedback.

We do agree though that periodic reporting should continue to be annual for most IBIPs, and not more frequently as is required for MiFID business.

*Q3: Do you agree with our proposals to implement the inducements-related requirements of the IDD? Where possible, please distinguish between the minimum directive requirements and areas where we have exercised discretion.*

FCA has set out areas where it is considering implementing the IDD rules as written, or extending them to fit with MiFID requirements:

- In paragraph 6.17 FCA comments on inducement rules relating to service, and highlights that whilst IDD focuses on inducements that do not have a detrimental impact on the quality of service, MiFID rules require that inducements must be designed to enhance the quality of service. FCA considers the MiFID arrangement is more appropriate, stating that “there are circumstances in which... (it)... may deliver better consumer outcomes”: we consider that where FCA intends to go beyond the IDD requirement, it should specify what those circumstances are, and if FCA is unable to do so it should retain the IDD requirement only.
- Paragraph 6.10 indicated FCA is not minded to apply the MiFID inducement requirements on investment research to IBIPs: we agree.

*Q4: Do you agree with our proposals to implement the suitability and record-keeping-related requirements of the IDD? Where possible, please distinguish between the minimum directive requirements and areas where we have exercised discretion.*

*Q5: Do you agree with our approach to exercising the Member State derogation for professional clients in order to align information disclosure requirements for the suitability statement with MiFID II?*

We agree on the points raised in this chapter.

*Q6: Do you agree with our proposals about how to implement the appropriateness-related requirements of the IDD? Where possible, please distinguish between the minimum directive requirements and areas where we have exercised discretion.*

*Q7: Do you agree with our proposal to exercise the Member State derogation related to execution-only sales in order to maximise the scope for this type of IBIP sale?*

FCA has indicated in the consultation that it wishes to ‘maximise the scope for execution-only sales’. This is helpful clarity, and indicates FCA will not impose any restrictions beyond those presented in the Directive or in EIOPA’s guidelines.

A key issue for many members of AFM is the definition of complex products, and its impact on whether they can distribute products on an execution-only basis. We have highlighted the difficulties to FCA of interpreting the current guidelines from FCA and EIOPA in relation to with-profits products. The nature of with-profits in the UK is not replicated in other parts of Europe, so we would not automatically assume that EIOPA guidelines/ delegated text would provide absolute clarity on UK-only products. In recent discussions, FCA has indicated it will respond once EIOPA’s final text responding to its consultation 17/001, providing guidelines on complex IBIPs, is published.

EIOPA did not publish their final report as expected in August, though they have since been published<sup>4</sup>. The subject of traditional or pooled IBIPs was discussed there, and EIOPA’s response reiterated that “mechanisms such as profit-sharing should (not) automatically result in a product being deemed complex”. Discretionary benefits, such as those provided in with-profits products are recognised as being contractual structures used in traditional life insurance policies that it did not intend to inadvertently capture in definitions of complexity.

This clarity is helpful, and we look for FCA to reinforce this position in its response to the consultation. The EIOPA guidelines provide a detailed flow charts firms need to adopt for an execution-only sale, and we think that together this would give confidence to customers buying traditional products on an execution-only basis.

In addition, the delegated regulations, published in July state:

*“criteria should be set for the assessment of whether an insurance-based investment product that does not meet the conditions set out in point (a)(i) of Article 30(3) of Directive (EU) 2016/97 might nevertheless be considered a non-complex product. In that context, the provision of guarantees can play an important role. Where an insurance-based investment product provides a guarantee at maturity that covers at least the total amount paid by the customer, excluding legitimate costs, such guarantee limits*

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<sup>4</sup> [https://eiopa.europa.eu/Publications/Reports/Final\\_Report\\_IDD\\_guidelines\\_execution\\_only.pdf](https://eiopa.europa.eu/Publications/Reports/Final_Report_IDD_guidelines_execution_only.pdf)

*significantly the extent to which the customer is exposed to market fluctuations. It is therefore justified to consider such a product, subject to further conditions, as a non-complex product for the purposes of Article 30(3) of Directive (EU) 2016/97.”*

This would appear to indicate that with-profits investment products with a maturity guarantee would ordinarily be regarded as non-complex. This would include most Tax Exempt Savings Plans offered by friendly societies. We would welcome early clarity on this by FCA, as the current uncertainty, caused in part by delays in EIOPA, means organisations are taking different views based on their interpretation of the draft text from EIOPA.

Additionally, a number of Friendly Societies operate a fund where the customer has no choice as to the underlying investment. The examples given by EIOPA indicate that in instances where the customer does not make an investment selection and where the surrender and maturity proceeds reflect the performance of the underlying investments (as is typically the case with with-profits contracts) that the product may be regarded as non-complex.

FCA is also aware that a number of friendly societies offer Holloway income protection contracts, with a degree of bonus sharing, that FCA regards as with-profits. All Holloway products are predominantly protection based, but the amount of bonus element will vary by provider. In preparation for the RDR, FSA agreed on a version of the product ('Holloway lite') where the level of premium devoted to bonus allocation was very low. In recent discussions, FCA suggested a Holloway that was predominantly protection focused would fall outside the definition of IBIP. That being the case, where all Holloways are constructed with a great deal less than 50% of premiums devoted to bonus allocation, that would indicate all Holloways are not IBIPs and therefore the issue of non-advised sales falls away in relation to chapter 8 of the consultation.

These are all issues our members need early views on, to ensure their distribution processes remain appropriate from the date of implementation of the IDD.

We would also appreciate FCA's view on circumstances where a customer disregards a warning that they have failed an appropriateness test on a product. Our members are concerned that at a future time the Financial Ombudsman might be asked to consider whether such a sale constituted mis-selling, under the general TCF principle. We would welcome clarity therefore in such circumstances on which takes precedent, the COBS rules or Principles such as principle 6.

*Q8: Do you agree with our proposals to implement the conflicts of interest-related requirements of the IDD? Where possible, please distinguish between our proposals in respect of the minimum directive requirements and areas where we have exercised discretion.*

We have no comments.

*Q9: Do you agree with our proposed approach to the implementation of product oversight and governance rules for insurance products?*

We intend to comment on the product governance arrangements in response to FCA's third consultation, where the detailed proposals sit. We are particularly keen to avoid unnecessary extensions of IDD rules to reflect MiFID requirements for non-life products, where they carry much less relevance.

*Q10: Do you agree with our proposal to change the application of CASS 5 to make it mandatory instead of optional for reinsurance mediation? If not please provide reasons.*

We agree.

*Q11: Do you agree with our proposals for implementing the IDD good repute requirements?*

We agree.

*Q12: Do you agree with our proposed changes to the product information rules of ICOBS 6, including retaining the current policy summary document in relation to pure protection contracts?*

*Q13: Do you agree with our proposed rules implementing the IPID?*

We would suggest that some of the FCA views require further elaboration or consideration.

For example, some general insurance products are written on a monthly renewable contract. In paragraph 13.12, FCA suggests the provider is required to provide a IPIF for each new insurance policy, including on renewal. This would infer needing to provide an IPID every month.

IDD states that the product information should be provided prior to the conclusion of the contract. In paragraph 13.6 FCA indicates information should be provided at the point where it will be most useful to the customer. We can see the sense in FCA's interpretation, but it would be helpful to see more clarity on what this involves.

FCA's summary answer, that the IPID needs to include customer specific data, such as the sum insured, start date and end date appears to conflict with the possibility that personalised information can be incorporated by reference to other documents. This will make a big difference to the ability for some firms to provide the IPID quickly and prior to sale, and we would welcome more clarity from FCA.

*Q14: Do you agree with our proposed amendment to the disclosure requirements for third-party processors? If not, please explain why.*

We agree.

*Q15: Do you agree with our proposed consequential changes to these Handbook modules?*

We have no comments on the consequential changes proposed.