

CHANGES OF INSURANCE INTERMEDIARIES REGULATION IN THE EU COUNTRIES

Valentina Peleckiene¹, associate prof.; **Kestutis Peleckis**², professor; **Gitana Dudzeviciute**^{3,6}, associate prof.; **Kestutis Peleckis**⁴, lecturer; **Giedre Lapinskiene**⁵, lecturer

^{1,2,3,4,5} Vilnius Gediminas Technical University, Lithuania

⁶ General Jonas Zemaitis Military Academy of Lithuania, Lithuania

Abstract. This paper describes the changes, which were made in recent years to the regulation of insurance intermediaries in the EU countries. The Insurance Distribution Directive (IDD) came into force on 22 February 2016 and updates the 2002 Insurance Mediation Directive (IMD), applies to the wider regulation of insurance "distributors" in comparison with IMD. The IDD has a wide scope of application, applying to all sellers of insurance products, anyone who assists in the administration and performance of insurance contracts and ancillary insurance intermediaries. Member States have two years to transpose the IDD into national laws and regulations, which should provide for significant changes in practices of selling insurance products and guarantee enhanced level of consumer protection. The aim of article is reveal the problem areas of IDD implementation in order to escape infringements. To achieve the aim of article, there were used the following approaches: systematic and logical analysis, generalization, analysis of documents, qualitative content analysis, empirical data collection and systematisation. Conclusions of article are as following: agents and brokers are the main non-life distribution channels, and banc-assurance is one of the main life distribution channels, insurance intermediaries foster competition in the local and the EU insurance market, diversity of channels, which makes it possible for insurers to adjust to differing cultures, needs and preferences in different markets, is in the interest of consumers, effective implementation of new Insurance Distribution Directive will help to make changes in organisation, professional requirements, remuneration and forecasting the challenges.

Key words: insurance distribution, insurance mediation, sellers of insurance products, revision of IMD, insurance brokers, agents, ancillary insurance intermediaries.

JEL code: G18, G22, G24.

Introduction

The macroeconomic environment for European insurers improved in 2015. The European economy continued to grow modestly, with the real gross domestic product (GDP) of the 28 EU Member States increasing by 2.2 % after 1.6 % growth in 2014 (European Insurance in Figures 2015). The European market continued to grow in 2015, with total premium income up 2 %. Within that total, non-life business lines grew 2.4 %, but in the life insurance growth was lower – 1.5 % (European Insurance in Figures 2015). Around 3 600 insurance companies were active in Europe in 2015, a decrease of 3.7 % in 2014. This total refers to the number of domestic companies and branches of non - EU/ EEA (European Economic Area) country companies. In addition, in 2014, 540 branches of EU/EEA companies were operating in the EU and around 7 400 licensed insurance operations were overseen by national supervisory authorities on the basis of freedom of services. Germany was the market with the highest number of insurance companies in 2015 (539), experienced decrease

of 1.6 % in 2014. The number of companies in the UK, the second largest market, decreased in 2015 to 496. In third and fourth markets – France and Sweden – also experienced a decrease in their number of companies, by 4 % and 7 % respectively (European Insurance in Figures 2015).

Insurance intermediaries foster competition in the local and EU insurance market. Insurance is sold either directly by insurers or through a number of different channels, the most common of which are brokers, agents and banc-assurance (Lace *et al.*, 2016). The popularity of each channel of insurance distribution varies depending on both the market and the insurance product (Domaradzka, 2012). This diversity of channels, which makes it possible for insurers to adjust to differing cultures, needs and preferences in different markets, is in the interest of consumers. Agents and brokers are the main non-life distribution channels, and banc-assurance is one of the main life distribution channels. The Insurance Mediation Directive (IMD) regulated the selling practices of all

¹ Corresponding author: E-mail address: valentina.peleckiene@vgtu.lt.

insurance products (Cummins *et al.*, 2016). It covers the regulation of general insurance products such as motor insurance as well as life insurance policies, including those which contain investment elements such as unit-linked life insurance products. The IMD approved principles that each Member State has implemented in substantially different ways. Certain parts of it are in need of modification or clarification, and some important matters proposed today do not fall within its current scope (Meron, Weill 2010; Okura 2010; Schiller 2009; Spitzer 2014). The Insurance Distribution Directive (IDD) came into force on 22 February 2016 and updates the Insurance Mediation Directive (IMD), applies to the wider regulation of insurance distributors in comparison with IMD. The IDD has a wide scope of application, applying to all sellers of insurance products, anyone who assists in the administration and performance of insurance contracts and ancillary insurance intermediaries (European Commission's Impact Assessment, 2015). Member States have two years to transpose the IDD into national laws and regulations, which should provide for significant changes in practices of selling insurance products and guarantee enhanced level of consumer protection. Implementation of IDD is important for each Member State.

The aim of the article is to disclose the problem areas related to implementation of IDD in order to avoid future infringements for Member States. In order to fulfil the defined aim, the following tasks have been raised: 1) to analyse non-life insurance and life assurance distribution channels; 2) to determine changes on regulation of insurance intermediaries; 3) to review and compare insurance statistical data of the EU countries.

Methodology of the research: systematic and logical analysis, generalization, analysis of documents, qualitative content analysis, collection of empirical data and systematisation.

Research results and discussion

1. Non-life insurance and life assurance distribution channels

Among the largest life insurance markets in 2015 of the EU countries, most products were sold via banc assurance in Italy (79 % of gross written premiums) and France (64 %), while in the UK and Germany most life products were sold by agents and brokers (83 % and 73 % respectively). The other European markets in which banc assurance was most dominant were Malta (82 %), Portugal (80 %), and Spain (63 %). The market in which agents and brokers were most dominant was Bulgaria (85 %). Agents alone were the main distribution channel in Slovenia (82 %) and Slovakia (63 %) (European Insurance in Figures 2015).

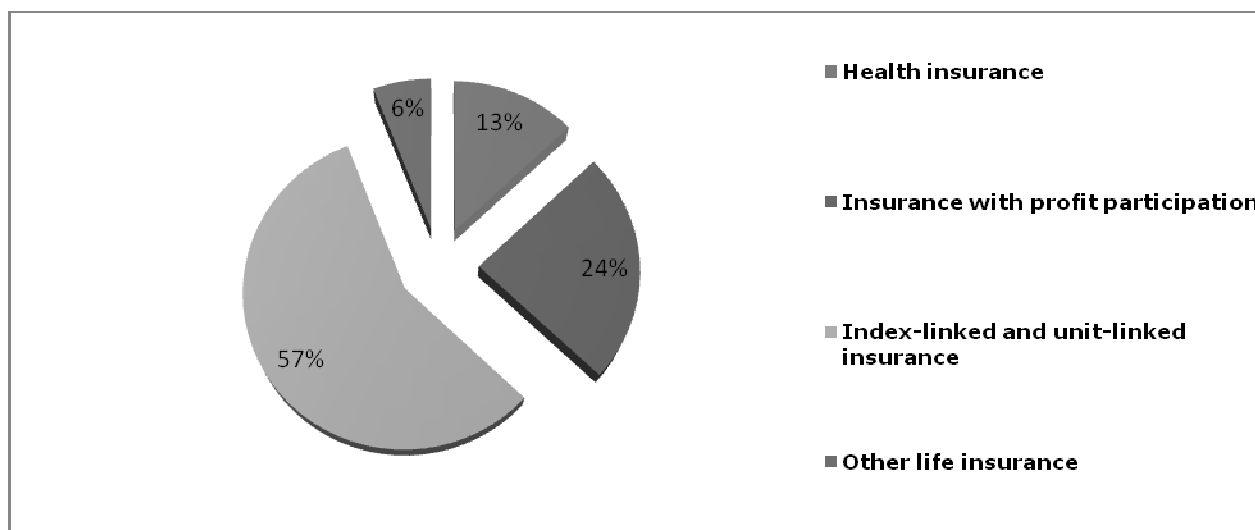
In both large and small markets, non-life insurance policies were mainly distributed in 2015 through agents and brokers. Agents predominate in Slovakia (80 %), Italy (79 %), Slovenia (62 %), Germany (58 %) and Portugal (56 %). Meanwhile, brokers account for 61 % of non-life premiums in Belgium and 50 % in Bulgaria. In contrast, Croatia had the largest proportion of nonlife products sold directly (70 %) (European Insurance in Figures 2015).

In Lithuania, the volume of single life assurance premiums in I half of 2016 shrank by more than 10 million EUR, thus determining a fall in the life assurance market volume. As a comparison of the data for the first halves of the past few years, 2016 year's situation is similar very much to that observed in 2012, when the life assurance market share contracted by more than 11 per cent due to a more than 60 per cent decline in the volume of single premiums (Bank of Lithuania).

The insurance premiums of four insurance undertakings in Lithuania distributing non-life assurance products and of nine branches registered in other EU countries and providing services in Lithuania amounted to EUR 230.1 million over the half-year 2016 and were the largest in the last five years (Bank of Lithuania).

Advances in distribution are driven by changes in the needs and preferences of insurance products' consumers as well as by regulatory and technological developments (Peleckiene, Peleckis, 2015). Accordingly, insurers are trying to develop

multi-channel strategies and invest in new technologies to create innovative ways of selling products that can improve their service to consumers and respond to their expectations.



Source: Bank of Lithuania

Fig.1. Distribution of life assurance premiums in Lithuania by type in 1st half of 2016

Fig.1 represents the distribution of life assurance premiums in Lithuania by type during the first half of 2016. It should be noted, that among premiums, collected by insurers of life assurance, prevailed index-linked and unit-linked insurance - 57 %, premiums of insurance with profit participation - 24 %, the least amount of premiums consisted of health insurance - 13 %.

The number of Lithuanian insurance brokerage firms in 2016 year amounted to 97. The amount of insurance brokerage firms is decreasing: on 31 December 2013, there operated 101 insurance brokerage firms in Lithuania's insurance market - two licences were issued and two licences were revoked according to Bank of Lithuania. In 2016, the number of insurance contracts concluded by insurance brokerage firms exceeded 1 million. In 2015, insurance brokerage firms intermediated in the conclusion of 1.24 million insurance contracts and pension accumulation agreements - an increase of 9.7 per cent from 2012. As usual, insurance brokerage firms operated most actively in the non-life insurance market. With their intermediation, 1.23 million insurance contracts were concluded - 23.8 per cent of the contracts

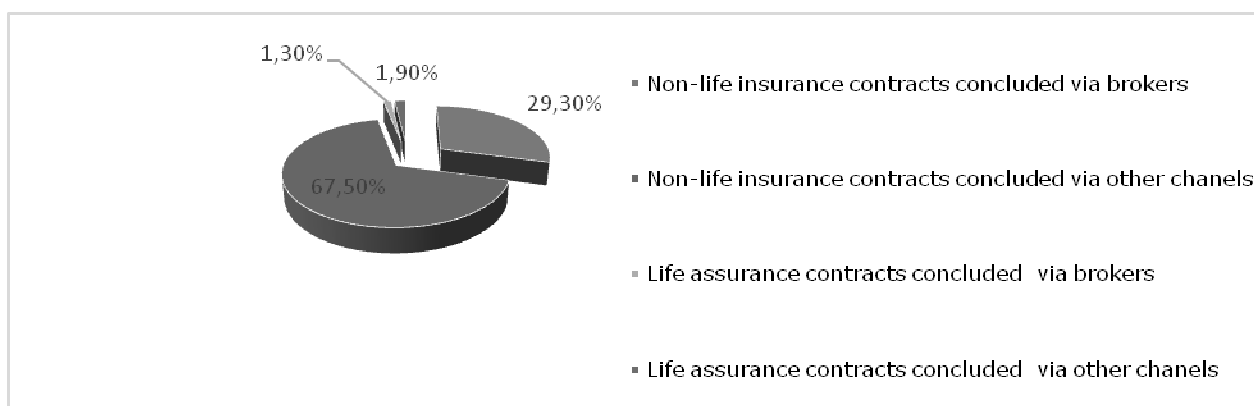
of this branch in the insurance market. As many as 99.8 per cent of the insurance contracts and pension accumulation agreements concluded via the intermediation of insurance brokerage firms were represented by non-life insurance contracts (Peleckis, Peleckiene *et al.*, 2016).

The data presented in Fig. 2 describe by what channels life and non-life insurance premiums were collected. In non-life insurance, 29.3 % contracts were concluded by brokers' undertakings and by other channels of sale - 67.5 %. In life insurance: only 1.3 % of contracts were concluded by brokers' undertakings, and 1.9 % - by other channels of sale (Bank of Lithuania).

The assets of insurance brokerage firms of Lithuania during first quarter of 2016 amounted to 24.2 million EUR, equity capital - 13.6 million EUR. On 31 March 2015, the minimum equity capital (capital cannot be less than EUR 18 760) requirements were not fulfilled by one insurance brokerage firm, which was warned and obliged up to 30 June, 2015 to ensure equity requirement. Two insurance brokerage firms also had to take the measures necessary to comply with the

minimum capital requirement. The company's shareholders contributed funds to cover the losses. The insurance brokerage firms' income from sales per year amounted to 9.7 million EUR. Although in 2015 one quarter of insurance

brokerage firms operated at a loss, however, the entire sector's overall performance during the reporting period amounted to a 10.8 million profit.



Source: Bank of Lithuania

Fig.2. Channels of Insurance contracts concluded in life and non-life insurance of Lithuania

This was mostly driven by the 8.3 per cent growth over the year in income from sales. The income from sales of the five largest insurance brokerage firms accounted for 45.2 per cent of the total income of all insurance brokerage firms. By income from sales, the market leader among the insurance brokerage firms continues to be Aon Baltic. Its assets accounted for 32.5 per cent of the total income from sales of all insurance brokerage firms. The aforementioned firm has retained its leadership positions by other indicators as well: its assets accounted for 35.2 per cent of the system's assets; income - 18.9 per cent from all profits of sector.

2. Changes to the regulation of insurance intermediaries

The Insurance Distribution Directive (IDD) is essential of the EU legislation in regulating insurance intermediaries, came into force on 22 February 2016. This Directive (EU) 2016/97 on Insurance Distribution (Recast) focuses on practices for selling insurance products and in particular seeks to establish a level playing field between participants in insurance sales in order to improve customer protection, strengthen competition and facilitate market integration. The IDD updates the 2002 Insurance Mediation Directive 2002/92/EC (the 2002 Directive), which

introduced a framework for regulating EU insurance brokers, agents and other intermediaries. The IDD has a wide scope of application, applying to all sellers of insurance products (including those that sell directly to customers and price aggregator comparison websites), anyone who assists in the administration and performance of insurance contracts (e.g. claims management activities, Lloyd's managing agents, service companies dealing with customers) and ancillary insurance intermediaries. It applies both to insurance and reinsurance distribution. The essential aim of the IDD is to ensure that insurance intermediaries would act professionally, honestly, fairly and in the best interests of their clients. The following specific provisions include:

- 1) **Professional development:** employees of insurance intermediaries must complete at least 15 hours of professional training or development per year.
- 2) **Disclosure:** before the conclusion of a contract, intermediaries must disclose to their customers the nature and basis of their remuneration (e.g. fee and commission).
- 3) **Remuneration:** intermediaries must not remunerate or assess the performance of employees in a way which conflicts with their

duty to act in the best interests of their clients.

- 4) **Provision of information:** intermediaries must provide certain information to their customers (e.g. product information document, which summarises the main features of the proposed contract).

The IDD is a "minimum harmonising" Directive and Member States will be able to implement it

by adding extra requirements. That said the IDD is intended to raise significantly the minimum standards of the IMD. In Table 1 are presented comparison of main requirements in IDD and IMD. The new IDD regime will simplify the procedure for cross-border entry to insurance markets across the EU in a number of ways.

Table 1

Comparison of the scope of Insurance Mediation and Insurance Distribution Directives

Insurance Mediation Directive (IMD)	Insurance Distribution Directive (IDD)
IMD applies to insurance intermediaries only. Covers about 48 % of the market.	IDD applies to all sellers of insurance products, including insurance undertakings that sell directly to customers. IDD covering about 98 % of the market.
IMD covers only those acting on behalf of the policyholder.	IDD applies to any person whose activities consist of assisting in the administration and performance of insurance contracts, including those acting on behalf of insurers – for example, claims management activities. However, the new directive extends its application more widely to others who assist in the administration and performance of insurance contracts – for example, in the event of a claim.
IMD contains a similar "connected contracts" exemption, although there are changes to the conditions that need to be met to rely on this test. Any person that does business on the basis of the exemption should confirm that they are still able to meet these conditions and do not need to be authorised.	IDD was extended to include ancillary insurance intermediaries, although a lighter touch regime will apply and member states are entitled to require that insurers and intermediaries take greater responsibility for ancillary intermediaries. Ancillary intermediaries must meet three conditions to avoid full regulation, including that the insurance products concerned must not cover life assurance or liability risks unless that cover complements the product or service which the intermediary provides as his principal professional activity.

Source: prepared by authors based on IDD

Member States will be expected to establish a "single information point" providing public access to their registers for insurance, reinsurance and ancillary intermediaries. IDD applying to any person may improve service provision for insurers as such firms will have better controls in place, but additional costs may be passed onto insurers. Firms will need to confirm that all such entities, that they do business with, are properly authorised and that their contractual arrangements reflect the change in regulation. Notably, the management of claims of an insurer/ /reinsurer on a professional basis, loss adjusting and expert appraisal of claims have been 'carved out' of the extended definition.

3. Organisation, professional requirements and remuneration

The new regime will require stricter and more specific professional requirements. The EU Member States will have to establish and publish

mechanisms to effectively control and assess the knowledge and competence of insurance and reinsurance intermediaries and employees of insurance and reinsurance undertakings and employees of insurance intermediaries. Commissions paid by insurance companies are still the major source of underwriting-related income for independent intermediaries. Most commission payments are related to the signing of the contract and are conditioned mostly on the insurance premium (Focht *et al.*, 2013). For example, in Lithuania there is still under discussions the question who should pay the broker (consumer or insurer). Home Member States may require that intermediaries would have training and their development requirements would be proven by obtaining a certificate. The IDD also sets a minimum professional indemnity insurance requirement for intermediaries of at least €1.25 million per claim

or €1.85 million in aggregate, unless such insurance or comparable guarantee is already provided by an insurance or other undertaking on whose behalf the intermediary is acting. This is currently €1 million or €1.5 million under the IMD. Ancillary insurance intermediaries will also be required to hold professional indemnity insurance. Remuneration disclosure requirements for insurance intermediaries in the current version of the IDD include disclosure of the following.

- 1) The nature of remuneration received in relation to an insurance contract.
- 2) The basis of the remuneration – that is, whether it is in the form of a fee paid by the customer, a commission included in the insurance premium, an economic benefit of any kind offered or given in connection with the insurance contract, or a combination of these. Where the fee is payable directly by the customer, intermediaries must disclose the amount of the fee or, where this is not possible, the method for calculating it.
- 3) If any payments, other than ongoing premiums and scheduled payments, are made by the customer under the insurance contract after its conclusion, the insurance intermediary will also be obliged to make the disclosures after each of these payments.

Remuneration is defined in the Directive as meaning: "any commission, fee, charge or other payment, including an economic benefit of any kind or any other financial or non-financial advantage or incentive offered or given in respect of insurance distribution activities". The disclosure of remuneration requirements for insurers in the IDD include disclosure of the nature of the remuneration, received by their employees in relation to the insurance contract. In addition, if any payments other than ongoing premiums and scheduled payments are made by the customer under the insurance contract after its conclusion, the insurer will also be obliged to make the disclosures after each of these

payments. Remuneration disclosure requirements for ancillary insurance intermediaries in the IDD include only the nature of the remuneration received in relation to the insurance contract.

Conclusions, proposals, recommendations

- 1) The application of Directive 2002/92/EC has shown that a number of provisions require further precision with a view to facilitating the exercise of insurance distribution and that the protection of consumers requires an extension of the scope of that Directive to all sales of insurance products.
- 2) Various types of persons or institutions, such as agents, brokers and banc assurance operators, insurance undertakings, travel agents and car rental companies can distribute insurance products. Equality of treatment between operators and customer protection requires that all those persons or institutions be covered.
- 3) Insurance intermediaries foster competition in the local and the EU insurance market. Insurance is sold either directly by insurers or through a number of different channels, the most common of which are brokers, agents and banc assurance. The popularity of each channel of insurance distribution varies depending on both the market and the insurance product. This diversity of channels, which makes it possible for insurers to adjust to differing cultures, needs and preferences in different markets, is in the interest of consumers.
- 4) The Insurance Distribution Directive (IDD), is essential of EU legislation in regulating insurance intermediaries, focuses on practices for selling insurance products and in particular seeks to establish a level playing field between participants in insurance sales in order to improve customer protection, strengthen competition and facilitate market integration.
- 5) Implementation of new Insurance Distribution Directive till 2018 is important for each

Member State, so it is very important for insurance intermediaries to prepare and make changes in organisation, professional requirements, remuneration and forecasting what challenges they will face in the future.

- 6) Insurance companies must ensure that insurance intermediaries would act professionally, honestly, fairly and in the best interests of their clients.
- 7) Before the conclusion of a contract, intermediaries must disclose to their customers the nature and basis of their remuneration (e.g. fee and commission).

- 8) It is recommended for insurance companies and insurance brokerage firms to focus attention to the remuneration of independent agents and brokers in order that commissions paid by insurance companies would be based on various performance criteria, such as profitability of the business placed or the volume of business with that specific insurer.
- 9) Intermediaries must provide certain information to their customers (e.g. product information document, which summarises the main features of the proposed contract).

Bibliography

1. Bank of Lithuania. (2017). *Review of the Activities of Insurance Brokerage Firms*. Insurance Mediation Activity Performance. Retrieved: https://www.lb.lt/insurance_mediation_activity_performance. Access: 12.01.2017.
2. Cummins, J.D., Rubio-Misas, M., Vencappa, D. (2016). Competition, Efficiency and Soundness in European Life Insurance Markets. *Journal of Financial Stability* 2016, No 28: pp.66-78.
3. Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on Insurance Mediation, OJ L 009, 15 January 2003.
4. Directive 2016/97 of the European Parliament and of the Council of 20 January 2016 on Insurance Distribution (recast), OJ L 26/19, 22 January, 2016.
5. Domaradzka, A. (2012). The Revision of the Insurance Mediation Rules at EU Level and its Impact on Consumer Protection. EIPA, Luxembourg.
6. *European Commission's Impact Assessment Accompanying the Proposal for a Directive on Insurance Mediation*. Retrieved: http://ec.europa.eu/internal_market/insurance/docs/consumers/mediation/20120703-impact-assessment_en.pdf, pp. 20-22 Access: 12.06.2016.
7. European Insurance in Figures 2015 data. *Insurance Europe's annual European Insurance in Figures Statistical Publication*. Retrieved: <http://www.insuranceeurope.eu/european-insurance-figures-2015-data>. Access: 12.06.2016.
8. Focht, U., Richter, A., Schiller J. (2013). *Intermediation and (Mis-)Matching in Insurance Markets – Who Should Pay the Insurance Broker? The Journal of Risk and Insurance* Vol. 80, No. 2 (June 2013), pp. 329-350.
9. Lace, N., Polajeva, T., Peleckis, K., Peleckiene, V. (2016). *Insurance Distribution Channels in European Union Countries*. The priorities of the world science: experiments and scientific debate. North Charleston, SC, USA: CreateSpace, pp. 78-87.
10. Meron, P., Weill, L. (2010). Does Financial Intermediation Matter for Macroeconomic Performance? *Economic Modelling* 27, pp. 296–303.
11. Okura, M. (2010). The Vertical Differentiation Model in the Insurance Market. *International Journal of Economic and Business Modelling* 2010, No.1 pp. 12-14.
12. Peleckis, K., Peleckiene, V., Lace, N., Polajeva, T., Nedelko, Z., Potocan, V. (2016). *Globalization of Insurance Industry*. 16th International scientific conference "Globalization and its socio-economic consequences", 5th-6th October 2016, Rajecke Teplice, Slovak Republic. Zilina : University of Zilina, pp. 1649-1656.
13. Peleckis, K., Peleckiene, V., Simelyte, A. (2015). *Comparative Analysis of Insurance Compensation in European Union*. The priorities of the world science: experiments and scientific debate. North Charleston, SC, USA: CreateSpace, pp. 95-100.
14. Peleckiene, V., Peleckis K. (2011). *Consultation of Insurance Industry - Condition of Solvency II Effective Implementation into National Legislation*. Management Consulting: the Central and Eastern European Perspective. Cracow : Cracow University of Economics Foundation, pp. 87-100.
15. Spitzer, M. Insurer Performance and Intermediary Remuneration: The Impact of Abandonment of Contingent Commission. *The Geneva Papers on Risk and Insurance – Issues and Practice*. April 2014, Volume 39, Issue 2, pp. 373–388.