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# *The financialisation of insurance distribution*

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**ABSTRACT:** This article deals with the impact of the MiFID system on the regulation of insurance distribution in a financialisation process, using Spanish IDD transposition Act as reference. MiFID II and its different levels have established a system of financial regulation that acts as a model for the entire financial sector, including insurance distribution. It regulates the business of manufacturing financial instruments and subsequently offering them to investors. Product governance rules act as a preventive filter to ensure that products and services offered in the market serve investors' interests. It is a market filter, which is completed with the customer's evaluation on the provision of distribution services. In this way, a reciprocal and interconnected system is created that covers the product's entire life cycle. The IDD extends this MiFID system to the production and distribution of insurance.

**KEYWORDS:** MiFID II, IDD, product governance, customer evaluation (KYC), customer protection, civil liability, legal certainty, insurance-based investment products (IBIPs).

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## I. INTRODUCTION

Insurance distribution is part of the distribution of financial products. The stability of financial institutions, the integrity of the market and customer protection are shared objectives for financial market regulation. They are applied to the credit market, the securities market and also the insurance market.[1] It is true that insurance has always been

[1] This has constitutional relevance, since exclusive powers over the "bases for regulating credit, banking and insurance" are reserved for the State (art. 149.1.11 of the Spanish Constitution).

the absent guest in financial regulation. In fact, treatment of it has been kept separate.[2] However, the existence of risks common to the rest of financial products and services makes it advisable to extend the system of transparency and customer protection to insurance.[3] Technological innovation with the use of financial applications through online platforms creates business models that combine different financial products, including insurance. Convergence of the rules for financial distribution makes it easier for new financial services platforms to enter the market.

In the European Union, the regulation of the securities market has led the way in financial regulation, in particular in relation to the distribution or marketing of financial products. In this area, the first regulation concerning the financial market was the Commission Recommendation of 25 July 1977 concerning a European code of conduct relating to transactions in transferable securities, which was an essential element in creating a "common market". Good conduct was thus given priority over prudential aspects connected to the stability of intermediaries. As stated in the explanatory memorandum of this recommendation, the ethical approach has been given priority over the legislative approach. It includes a duty to refrain from any conduct that may hinder the proper functioning of the market. The financial market, which involves goods based on trust, relies on good conduct by the intermediaries[4]. These solid foundations were developed somewhat timidly in the ISD.[5] They were then developed in greater detail in MiFID I,[6] and more completely in MiFID II,[7] which includes product governance in the

[2] The existence of laws on insurance contracts in Member States has hindered the creation of European regulations. See Herman COUSY, “Le secteur des assurances sera-t-il mifidisé?”, *Tijdschrift voor Verzekeringen/Bulletin des Assurances*, 2009, vol. 89, no 3, page 245.

[3] It is part of the process of "despecialisation", which began in the credit market with the creation of banking and insurance institutions that integrated prudential control processes, according to Herman COUSY, “Le secteur des assurances sera-t-il mifidisé?”, *Tijdschrift voor Verzekeringen/Bulletin des Assurances*, 2009, vol. 89, no 3, page 245.

[4] “Credence goods” in the terms used in economic literature, from the seminal work by G. A. Akerlof, “The market for lemons: Quality uncertainty and the market mechanism”, *The Quarterly Journal of Economics*, volume 84, issue 3, pages 488-500. Financial products consist of promises that cannot be assessed by the customers acquiring them, who have to trust in the professional offering them. This notion is accepted in legal doctrine. For all of these, see John ARMOUR, Dan AWREY, Paul DAVIES, Luca ENRIQUES, Jeffrey N. GORDON, Colin MAYER, and Jennifer PAYNE, *Principles of Financial Regulation*, 2016, according to whom: “Financial products and services frequently fall into the credence category because there are no reliable benchmarks against which to evaluate performance” (page 57).

[5] Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, article 11 of which concerns "rules of conduct".

[6] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments, a section of which, articles 19 to 24, concerns rules of conduct to ensure investor protection.

[7] Directive 2014/65/EU of 15 May 2014 on markets in financial instruments, which expands the section concerning provisions to ensure investor protection, articles 24 to 30, including product governance among the organisational requirements (article 16).

rules of conduct in order to ensure that investment products and services meet customers' needs.[8]

In the field of insurance, Directive 2002/92/EC of 9 December 2002 on insurance mediation devoted a couple of articles to the obligation to inform, without providing details of the rules of conduct that already applied to investment services.[9] It was a minimum harmonisation directive that allowed Member States to adopt stricter customer protection rules.[10] One important novelty arrived with Directive 2009/138/EC of 25 November 2009, known as "Solvency II", which placed an obligation on insurance companies to have an "effective system of governance which provides for sound and prudent management of the business", but did not go as far as to include rules of conduct or transparency in relation to the customer, nor did it address the necessary governance of insurance as a financial product.[11] It was Directive 2016/97 of 20 January 2016 on Insurance Distribution (referred to below as the IDD), which incorporated the MiFID into insurance with the appropriate adaptations.[12] The IDD "MiFIDises" or "financialises" insurance, which is now regulated as what it is: a financial product.[13] For this reason, it

[8] See Veerle COLAERT, "Product Governance: Paternalism Outsourced to Financial Institutions?", 2019, available at SSRN 3455413, who proposes amending the product governance system to overcome its excessive paternalism.

[9] See article 12 regarding the contents, and article 13 concerning the form, of the duty to inform.

[10] The Spanish regulation transposing the directive, and its subsequent reforms, merely transposed the directive without adding additional rules of conduct to keep protection of the insured in step with investor protection. Directive 2002/92/EC was incorporated into domestic law by the Private Insurance and Reinsurance Mediation Act 26/2006 of 17 July [*Ley 26/2006, de 17 de julio, de mediación de seguros y reaseguros privados*]. This act has been criticised for its lack of technique and for being too receptive to certain industry demands. See Juan BATALLER GRAU, "La incesante reforma del derecho del seguro ¿último acto?", *Comentarios a la Ley de Mediación de Seguros y Reaseguros Privados*, coord. by Vicente CUÑAT EDO and Juan BATALLER GRAU, 2007, pages 77-81. Beforehand, the Private Insurance Mediation Act 9/1992 of 30 April [*Ley 9/1992, de 30 de abril, de mediación de seguros privados*] was passed to "bring the regulations concerning insurance distribution up to the same level of development as the supervision of institutions" (section 2 of the preamble). It is limited to regulating mediation through agents or brokers; other distribution channels are given freedom of action.

[11] See art. 41.

[12] This follows the path marked out by paragraph 87 of MiFID II, according to which rules of business conduct for insurance-based investment products should be established in the ongoing review of Directive 2002/92/EC in order to "ensure a consistent regulatory approach concerning the distribution of different financial products which satisfy similar investor needs and therefore raise comparable investor protection challenges." Although this path was marked out for insurance-based investment products, such as unit-linked products, the IDD extends its scope to all kinds of insurance, albeit with enhanced protection for insurance-based investment products. Concerning the nature of unit-linked products see Alberto Javier TAPIA HERMIDA, "Noción del seguro de vida unit-linked", *Revista española de seguros: Publicación doctrinal de Derecho y Economía de los Seguros privados*, 2018, no. 176, pages 477-506, who highlights their "specific regulatory problems" (page 483).

[13] See Herman COUSY, "Le secteur des assurances sera-t-il mifidisé?", *Tijdschrift voor Verzekeringen/Bulletin des Assurances*, 2009, vol. 89, no 3, pages 245-254; MARANO, PIERPAOLO, "La "mifidización": el atardecer de los seguros de vida en la normativa europea sobre seguros", *Revista española de seguros: Publicación doctrinal de Derecho y Economía de los Seguros privados*, 2017, no. 171, page 415-432. Also, Veerle COLAERT, "21.- Mifid II in relation to other investor protection regulation: picking up the crumbs of a piecemeal approach", in D. BUSCH and G. FERRARINI (dir),

is worth analysing the new insurance distribution regulation from the perspective of the experience and doctrine of the MiFID system, as well as ESMA's and the EBA's supervisory experience, set out in the form of criteria and guidelines that are of great importance in understanding the new legal framework.

Due to the influx of credit market regulations in response to the 2008 financial crisis, priority has been given to solvency as a main objective of financial regulation. However, protecting the solvency of intermediaries does not ensure proper functioning of the market by itself. It is necessary to combine it with good conduct by intermediaries. They must comply with the rules of conduct, information transparency and suitability for the customer profile, rounded off with product governance, a filter that is intended to ensure that the products marketed meet customers' needs. In an initial stage, customer protection is based on transparency. The efficient market doctrine prevails, according to which the asymmetry between the customer and the intermediary may be overcome with adequate information, such that an informed customer may make an informed decision. Various studies have shown that, in complex markets such as the financial market, provision of information does not guarantee correct decision-making. There are behavioural biases and a lack of understanding, especially among retail customers.[14] While transparency is important, it is not sufficient to guarantee investor protection and proper functioning of the market. Retail customers lack the knowledge and skills to assess financial risks. Thus, transparency rules must be supplemented with rules concerning the suitability of products for customers' needs. This system, completed and consolidated with MiFID II, has served as inspiration for the credit market (MCD),[15] including payment services (PSD2)[16] and insurance distribution (IDD). Here we will deal with its impact on the regulation of insurance distribution.

As with the regulation of the securities market, a distinction is made in insurance regulation between the products and their supply in the market. The creation of financial products, including insurance products, is not restricted. The notion and system applicable to financial products, at least the most common ones, is set out in codes or in special regulations. Thus, under Spanish law the nature and system for shares and bonds, the main financial instruments traded on stock exchanges, is set out in the Companies

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*Regulation of the EU Financial Markets: MiFID II and MiFIR* , Oxford University Press, 2017, according to whom: “Even though an attempt has been made to level the legislative playing field with respect to conduct of business rules in the MiFID II and the IDD Level 1 directives, the danger of divergent interpretations and application at Levels 2 and 3 is real.”

[14] Concerning behavioural biases, see the magnificent *Guía de la CNMV sobre Psicología económica para inversores*, [Spanish Securities and Exchange Commission's Guide to Economic Psychology for Investors] at: https://www.cnmv.es/DocPortal/Publicaciones/Guias/Psicologia_economica_para_inversores.pdf

[15] Directive 2014/17/EU of 4 February 2014 on credit agreements concluded with consumers for residential property, which was partially transposed by the Real Estate Credit Contracts Regulation Act 5/2019 of 15 March [*Ley 5/2019, de 15 de marzo, reguladora de los contratos de crédito inmobiliario*].

[16] Directive (EU) 2015/2366 of 25 November 2015 on payment services in the internal market, which was partially transposed by Royal Decree-Law 19/2018 of 23 November on payment services and other urgent financial measures [*Real Decreto-ley 19/2018, de 23 de noviembre, de servicios de pago y otras medidas urgentes en materia financiera*].

Act.[17] In the same way, insurance, as a product subject to contracting, is regulated by the Insurance Contract Act 50/1980 of 8 October.[18] The relevant aspect from the point of view of financial regulation is how the product is put on the market and subsequently traded. This seeks to achieve an effective allocation of savings to productive investment, either directly through stock exchanges or indirectly, as allowed by insurance.

In short, the material purpose of regulating financial distribution is insurance as a financial product,[19] the nature and framework for which is set out in the Insurance Contract Act. In turn, the main objective of regulation and supervision of the industry “is adequate protection of policyholders and insurance beneficiaries”.[20] It is a sectoral regulation that seeks to ensure that the offer of insurance in the market meets the needs of the customers for which it is intended. In order to achieve this objective, product governance is established as a preliminary filter, and rules are issued for intermediaries, irrespective of whether they are directly sold by the producer or distributed through third parties.[21]

## II. THE SYSTEM OF CONDUCT OF BUSINESS RULES

The conduct of business rules for insurance distributors are aimed at protecting customers, in particular those that have the status of consumers. However, they also protect the proper functioning of the market. They have a dual objective, protection and efficiency, which we must always bear in mind. They are not contractual rules or mere codes of ethics.

Conduct of business rules are not merely ethical rules. They have autonomy and are a source of law. In contrast, codes of ethics are self-regulation initiatives imposed by the profession that are not regulatory in nature. Rules of conduct are administrative rules of economic public order, breach of which gives rise to punishable administrative offences.

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[17] See Royal Legislative Decree 1/2010 of 2 July, approving the Consolidated Text of the Companies Act [*Real Decreto Legislativo 1/2010, de 2 de julio, por el que se aprueba el texto refundido de la Ley de Sociedades de Capital*].

[18] *Ley 50/1980, de 8 de octubre, de Contrato de Seguro*. This law “neglects to regulate the contractual process” according to Francisco SOLA FERNÁNDEZ, *El proceso precontractual en el contrato de seguro: nuevo marco jurídico*, Fundación Mapfre, 2017, page 33.

[19] See the interesting reflections by VEIGA COPO, A.B., *Productos financieros y seguro*, Madrid, 2020, who considers that we are witnessing a “[g]rowing complexity, sophistication, combinations or mergers of linked products and blends that combine financial products from markets as heterogeneous as banking, the stock market and insurance” (page 105).

[20] Paragraph 16 of the preamble of Directive 2009/138/EC (Solvency II).

[21] This is a novelty compared with the Private Insurance Regulation and Supervision Act, which does not include rules of conduct and does not even mention conflicts of interest. See Francisco SOLA FERNÁNDEZ, *El proceso precontractual en el contrato de seguro: nuevo marco jurídico*, Fundación Mapfre, 2017, pages 27 and 28.

They establish and specify the good faith and contractual diligence of the distributor. They therefore have contractual relevance.[22]

The Insurance Contract Act (*Ley de Contrato de Seguro* - LCS) and the conduct of business rules in the IDD, which was transposed into domestic law by Royal Decree-Law 3/2020 of 4 February (*Real Decreto-ley 3/2020, de 4 de febrero* — referred to below as "RDLey 3/2020"),[23] do not always take the same approach. The LCS includes a duty on the insured to inform the customer, whether the policyholder or the insured, so he/she may assess the risk. The main flow of information is from the customer to the insurer. In principle, it is the customer who best knows the risk being insured. However, the conduct of business rules are based on a duty to know your customers in order to offer them products suited to their profile, having warned them of the risks. The distributor has a duty to propose suitable products and inform the customer. The LCS determines the contents of the contract, the parties' rights and obligations, in order to provide greater certainty in practising the profession, while the purpose of the conduct of business rules is to protect the customer. These different perspectives in one regulation and the other do not fit easily together.[24] Hence the argument that insurance is unique and incompatible with conduct of business rules from the field of investment services.

A section of RDLey 3/2020 is devoted to conduct of business rules. It distinguishes between general principles and specific rules, dealing with the duties of information, prevention of conflicts of interest and customer evaluation, as well as methods of conveying information. It also includes, in separate subsections, an article on cross-selling of insurance with other products or services,[25] and another on product governance. It sets out the principles but also the details of the information to be provided and the means to employ in conveying it. In contrast to the option chosen to transpose the directives on other financial sectors,[26] which use the act for the principles and aspects

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[22] In commentaries on the Mediation Act [*Ley de mediación*] of 2006, the best doctrine already highlighted that "the core [of mediation] is private law", criticising the lack of regulation of the *ius privatista.* See Juan BATALLER GRAU, "La incesante reforma del derecho del seguro ¿último acto?", Comentarios a la Ley de Mediación de Seguros y Reaseguros Privados, coord. by Vicente CUÑAT EDO and Juan BATALLER GRAU, 2007, pages 79 and 80.

[23] Royal Decree-Law 3/2020 of 4 February on urgent measures incorporating into the Spanish legal system various directives of the European Union in the field of public procurement in certain sectors; private insurance; pension funds and plans; tax matters and tax litigation [*Real Decreto-ley 3/2020, de 4 de febrero, de medidas urgentes por el que se incorporan al ordenamiento jurídico español diversas directives de la Unión Europea en el ámbito de la contratación pública en determinados sectores; de seguros privados; de planes y fondos de pensiones; del ámbito tributario y de litigios fiscales*].

[24] See Herman COUSY, "Changing insurance contract law: an age-old, slow and unfinished story" in *Insurance Regulation in the European Union*. Palgrave Macmillan, Cham, 2017. Pages 45-48. He considers that: "The law should not disregard the specificity of the insurance contract and its autonomous characteristics (page 48).

[25] See Rafael LA CASA, "Prácticas y ventas combinadas y vinculadas" in Juan BATALLER GRAU and Mª Rocío QUINTÁNS EIRAS, (Editors), *La distribución de los seguros privados,* Marcial Pons, 2019, pages 661-688, who considers it a "true first" to tackle "a potential source of harm to customers" (page 662).

[26] MiFID II was transposed by amending the Stock Market Act and through regulatory rules: Royal Decree 217/2008 of 15 February and Royal Decree 1464/2018 of 21 December. In turn, Directive

with contractual relevance and the regulation for the details, the IDD was transposed in a single legal text. This is not a good option since it freezes aspects at legal level that should have been dealt with in a transposing regulation. In addition to this, the transposition consisted of an almost literal copy of the directive's text, resulting in a rigid legal framework that has not been adapted to the domestic legal system.

The general principles for distributors' actions are the same as those that govern investment service providers. They must act “with honesty, fairness and professionalism, for the benefit of their customers' interests” (“*con honestidad, equidad y profesionalidad, en beneficio de los intereses de sus clientes*”).[27] They must be transparent, providing information that is “precise, clear and not misleading” ("*precisa, clara y no engañosa*") and authentic, distinguishing between information and advertising.

The conduct of business rules cover the product's entire life cycle, from product design (product governance) to offering it to the customer (conduct of business rules in customer relations). In accordance with the life cycle, it would be advisable to first analyse product governance, which regulates creation of the product and its distribution strategy, and then analyse the rules that govern the marketing of the product to customers.

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2015/2366 on Payment Services (PSD2) was transposed by Royal Decree-Law 19/2018 of 23 November and by regulatory rules: Royal Decree 736/2019 of 20 December and Order ECE/1263/2019 of 26 December. And the Directive on credit agreements concluded with consumers for residential property (MCD) was transposed by Act 5/2019 of 15 March and by Royal Decree 309/2019 of 26 April.

[27] Art. 172.1 of RDLey 3/2020, from art. 17.1 of the IDD, which takes it from art. 13 quinquies.1 Directive 2002/92/EC, added by art. 91 MiFID II. It is a poor translation of the English version of art. 17.1 of the IDD, according to which “*insurance distributors always act honestly, fairly and professionally in accordance with the best interests of their customers*”, which is reflected in the French version: “*les distributeurs de produits d’assurance agissent toujours de manière honnête, impartiale et professionnelle, et ce au mieux des intérêts de leurs clients*” and the Italian version: “*i distributori di prodotti assicurativi agiscano sempre in modo onesto, imparziale e professionale per servire al meglio gli interessi dei loro clienti*”. This is coherent with the principles that govern investment service companies, which must act “with honesty, impartiality and professionalism, in their customers' best interest” ("*con honestidad, imparcialidad y profesionalidad, en el mejor interés de sus clientes*") (art. 208 of the Stock Market Act [LMV]). This poor translation creates confusion and legal uncertainty in a topic that is essential to regulate the conduct of insurance distributors. We consider that all doctrine concerning the principle of "impartiality" ("*imparcialidad*") and acting "in the customer's interest" ("*en interés del cliente*") is applicable to the principle of "fairness" ("*equidad*") and acting "for the benefit of the customer" ("*en beneficio del cliente*"), which are terms erroneously translated in the IDD, the source of the text of the transposed regulation. "Impartiality" ("*imparcialidad*"), the term used in art. 24.1 of MiFID II, is replaced with "fairness" ("*equidad*"), in accordance with the literal wording of the IDD which uses the term in art. 17.1, although it prefers "impartiality" in art. 29.2.b); and acting "in the customer's interest" ("*en interés del cliente*") is replaced with "for the benefit of its customers' interests" ("*en beneficio de los intereses de sus clientes*"). However, in RDLey 3/2020 there is a reference to the duty to act "in the best interest" ("*en el mejor interés*") of the customer. However, it is limited to preventing conflicts of interest in distributed remuneration systems. It is true that the expression "*en beneficio del cliente*" (for the benefit of the customer) is frequently used in EU directives with the same meaning as "*en interés del cliente*" (in the customer's interest) (see paragraphs 71 and 104 in the preamble of MiFID II). Therefore, they are expressions that are used indistinctly.

## III. PRODUCT GOVERNANCE

The introduction of product governance is the main new feature in the new legal framework.[28] Control of insurance, as a product offered on the financial market, extends throughout the product's lifetime, from design to expiry. It is a new measure added to the duty of transparency that is characteristic of the conduct of business rules of the offeror when marketing the product. Its aim is to protect customers preventively, by preventing mis-selling of insurance. Measures are taken concerning producers to prevent the creation of products that do not satisfy the interests of the customers for whom they are intended, even if that may be profitable for the industry. It is intervention in the product that eliminates conflicts of interest from the outset, which is the purpose of Delegated Regulation 2017/2358, which ensures a homogeneous framework within the European Union for such a sensitive matter for the industry.[29]

The regulations concerning product governance comprise art. 25 of the IDD, which sets out the principles concerning the matter;[30] the Delegated Regulation, which specifies them "taking into account in a proportionate way the activities performed, the nature of the insurance products sold and the nature of the distributor"; EIOPA's preparatory guidelines on product governance;[31] and the transposition into domestic law by art. 185 of RDL 3/2020. In turn, the product governance guidelines issued by ESMA[32] and the EBA[33] have served as inspiration for EIOPA, in particular in resolving questions raised

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[28] See MARTÍNEZ-GIJÓN MACHUCA, P., "Requisitos en el diseño, aprobación y control de productos de seguro y en materia de gobernanza (comentarios al art. 59 del proyecto de ley de distribución de seguros)" in BATALLER GRAU, J. and QUINTÁNS EIRAS, Mª R. (Editors), *La distribución de los seguros privados,* Marcial Pons, 2019, pages 689-706, who describes it as "absolutely novel" (page 691).

[29] According to its preamble, it "ensures a coherent framework for all market operators and is the best possible guarantee for a level playing field, equal conditions of competition and an appropriate standard of consumer protection". It provides the industry with a safe haven in a very complex and novel field.

[30] See SOLA FERNÁNDEZ, F., *El proceso precontractual en el contrato de seguro: nuevo marco jurídico*, Fundación Mapfre, 2017, page 109 et seq.

[31] *Final Report on Public Consultation on Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and insurance distributors,* EIOPA-BoS-16-071, 6 April 2016.

[32] In the MiFID system, product governance is regulated in art. 16.3 of MiFID II, as part of the corporate governance system (art. 9.3), applying the general principles of customer protection (art. 24.1 and 2), developed by arts. 8 and 9 of Delegated Directive (EU) 2017/593, which is the framework targeted by the Guidelines on MiFID II Product Governance, 05/02/2018 | ESMA35-43-620 ES, available at https://www.esma.europa.eu/sites/default/files/library/esma35-43-620_guidelines_on_mifid_ii_product_governance_es.pdf.

[33] Also in the credit market, product governance is part of the organisational rules for good corporate governance (art. 74(1) of Directive 2013/36/EU), with specific rules of conduct for payment services (art. 11.4 of Directive 2015/2366, formerly art. 10(4) of Directive 2007/64/EC, and art. 3(1) of Directive 2009/110/EC) and real estate credit (art. 7(1) of Directive 2014/17/EU. This framework is systematically interpreted in the Guidelines on Product Oversight and Governance Arrangements for Retail Banking Products issued by the European Banking Authority (EBA), EBA/GL/2015/18, de 22/03/2016, available at https://eba.europa.eu/sites/default/documents/files/documents/10180/1412678/0defef0f-3f21-4e96-9175-73b1884e906a/EBA-GL-2015-18%20Guidelines%20on%20product%20oversight%20and%20Governance_ES.pdf. Delegated Regulation 2017/2358 on governance of insurance products takes its structure and much of its content, with

by operators.[34] The truth is that the principles of supervisory convergence and legal certainty make it necessary for the European authorities to engage in a coordinated effort. This should be leveraged in order to produce common guidelines on product governance within the framework of the ESAs Joint Committee to produce specific solutions for each sector.

RDLey 3/2020 merely copies and pastes the contents of the Directive, adapting the references to those affected to domestic terminology, replacing "*empresas de seguros*" with "*entidades aseguradoras*" for insurance undertakings and "*intermediarios*" with "*mediadores de seguros*" for intermediaries. There is only one significant change that affects the information that designers must make available to distributors. The IDD requires "adequate" information to be made available to distributors and the transposing regulation limits this to "relevant" information. In turn, article 8 of the Delegated Regulation maintains the terminology in the Directive, referring to "adequate" information, qualified in the preamble as "necessary" information to allow distributors to understand the product and the target market, so they may carry out their distribution activities in accordance with the best interests of their customers. The replacement of the term "adequate" information with "relevant" in the transposition is thus a technical inaccuracy that moves away from the product governance function. The purpose of this type of governance is to coordinate the design and distribution activities in order to ensure that customers are only offered products that meet their needs. In order to achieve this coordination, "adequate" information must flow for the performance of the governance process. This exchange of information between professionals is not an exchange of relevant information so that policyholders can take informed decisions. It is also not an exchange of relevant information about pricing that must be conveyed to the market.[35] It is a matter of sharing "adequate" information to perform the product approval process. Furthermore, "adequacy" as a requirement for the information to be shared allows better application of the proportionality principle.

By controlling good product governance, the legal framework extends its scope beyond "distributors" strictly speaking, i.e. those in the business of distributing the product. It regulates the distributor but also the producer or creator of the product. According to the Spanish legal dictionary, a "distributor" is the person “in the supply chain, other than the manufacturer or the importer, who makes a product available on the market”.[36] The same dictionary defines a "producer" as: “A business or professional that

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some changes in terminology, from these EBA Guidelines. The term "*diseñador*" ("designer") used by the EBA becomes "*productor*" ("manufacturer") and the EBA's "*mercado objetivo*" ("target market") is called the "*mercado destinatario*" (also "target market"); and it draws inspiration from EIOPA's preparatory guidelines.

[34] See Q&A product oversight and governance requirements for insurance, available at https://www.eiopa.europa.eu/qa-search/_en?f%5B0%5D=im_field_term_regulation_ref%3A1216

[35] In the sense stipulated in article 227 of the Consolidated Text of the LMV.

[36] This concept is taken from article 2.6 Regulation 765/2008 of 9 July 2008, establishing the requirements for accreditation and market oversight concerning the marketing of products [*Reglamento 765/2008, de 9 de julio de 2008, por el que se establecen los requisitos de acreditación y vigilancia del mercado relativos a la comercialización de los productos*].

manufactures or produces goods".[37] In this sense, the scope of the new legal framework, which ought to be reflected in its title, is "insurance production and distribution".

So-called product governance is an internal organisational measure imposed by intermediaries. Its origins are linked to the corporate governance rules in Solvency II.[38] Insurance undertakings must have governance systems that include policies concerning risk management, control and auditing.[39] They are prudential rules appropriate to good corporate governance. It is within this internal organisational framework for insurance undertakings that the "product governance" rules are located.[40] However, their purpose goes beyond stability, as they are intended to preventively protect the target customers of products. It is a matter of adapting production and distribution to customers' needs. In order to achieve this objective, companies must have product governance policies that define the markets the products are targeted at, determine the tests to be performed before launching them on the market, and make it possible to verify that insurers are applying them. These product governance rules act as a bridge between internal organisation and customer protection. In fact, product governance is included in the chapter of the IDD devoted to conduct of business rules.[41] In short, they are internal organisational rules aimed at improving companies' conduct in the market. This framing is maintained in the rule transposing it into domestic Spanish law. RDL 3/2020 devotes a subsection containing a single article to "Product control and governance requirements" in the section on "Information obligations and rules of conduct". Just like the other articles in this section, this article, 185, on product governance, is classified as "public interest rules" that distributors from other Member States must follow.[42]

The transposition has been performed without the necessary adaptation to domestic Spanish law. The product governance framework is that stipulated in the Directive

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[37] In this sector, "insurance production" is equivalent to the activity of mediation or also the set of transactions formalised within a period of time. The terminological diversity complicates the correct application of the new legal framework and makes it advisable to encourage the training of personnel and financial education of customers. The contrast between "*Entidades*" ["Undertakings"] and "*Distribuidores*" ["Distributors"] on the supervisor's website does not contribute to clarifying these concepts [http://www.dgsfp.mineco.es/es/Paginas/Iniciocarrousel.aspx visited on 2/7/2020].

[38] Directive 2009/138/EC of 25 November 2009.

[39] Article 41 of Directive 2009/138/EC.

[40] For coherence and systematic reasons, they should be called "product governance" rules as they are part of good corporate governance. We thus use governance and product governance interchangeably.

[41] Article 25, the last article in Chapter V on "Information requirements and conduct of business rules". However, in MiFID II, article 16 on product governance is part of chapter I, devoted to "Conditions and procedures for authorisation", outside of the section that covers "Provisions to ensure investor protection", which is included in chapter II on "Operating conditions for investment firms". As product governance has matured, it has split off from internal organisation to become part of the rules of conduct.

[42] According to that stipulated in article 211 of RDL 3/2020, which is confusingly worded, since it needlessly affects the subsection on additional requirements for insurance-based investment products. These rules must be published on the supervisor's website and communicated to EIOPA [an obligation of the Directorate General of Insurance and Pension Funds, which had not been complied with as of 14 June 2020], so that EIOPA can include them in the corresponding European register, available at https://www.eiopa.europa.eu/general-good-provisions_en?source=search

developed by the Delegated Regulation. It comprises the rules for the approval process and distribution mechanisms for insurance products. It applies to all manufacturers and distributors that produce, offer or advise on insurance products. The intermediary is considered to be a manufacturer when it plays a decisive role in the design.[43]

Its application is subject to the proportionality principle.[44] Simplicity takes priority for products that lack complexity, and rigour takes priority for more complex products, such as insurance-based investment products, referred to below as IBIPs or "investment insurance" for clarity's sake.

Product governance is deemed to be notwithstanding the application of the requirements of suitability, management of conflicts of interest and incentives.[45] One criterion in the MiFID system, which also applies to the framework of the IDD, is: “The identification of a target market by the distributor is without prejudice to the assessment of suitability”.[46] There are two levels, the general or macro level (product governance) and the individual or micro level (the suitability of the offer). The customer is protected throughout the product life cycle, first with general product governance protection and then, during marketing, with individual protection in which the suitability of the product for the customer is assessed.

The manufacturer plays the decisive role in designing the product by autonomously determining the essential features and main elements of the product, such as coverage, price, costs, risks, target market and compensation and guarantee rights.[47] A tailor-made product at the request of a customer is not considered manufacturing, as such activity requires designing for a number of customers.

Manufacturers are in charge of the product approval process, which includes its design, control, review and distribution. It is a formal process that must be documented.[48] It is a process that seeks a result. It must ensure that the product's design meets the needs of customers and does not cause adverse effects. There is a kind of Hippocratic oath. Just as doctors undertake to do no harm to patients' health, insurance manufacturers undertake not to do no harm to their customers' financial health. When harm is caused by an incorrect design, they must react to mitigate it. In order to ensure this undertaking is complied with, they must manage conflicts of interest. The staff involved in the design and distribution of products must be qualified in terms of their knowledge and experience

[43] “[H]aving a decision-making role in designing and developing that product” according to Preamble of Delegated Regulation 2017/2358. The mere adaptation of existing products “should however not be regarded as manufacturing”.

[44] “The measures and procedures shall be proportionate to the level of complexity and the risks related to the products as well as the nature, scale and complexity of the relevant business of the manufacturer” (art. 4.1 final of Delegated Regulation 2017/2358).

[45] Art. 25.3 of the IDD, art. 185.2 of RDley 3/2020.

[46] ESMA Guidelines (point 53, initial).

[47] See art. 3.1 and 3.2 of Delegated Regulation 2017/2358.

[48] Through a "control and governance policy". The use of different terms to refer to the same process makes it harder to understand.

of the products offered and the customers' characteristics. There are general training provisions that are reinforced for production and distribution personnel.[49]

When manufacturing is performed jointly by undertakings and intermediaries, there must be a collaboration agreement setting out the responsibilities that aids supervision.[50] If design is outsourced, manufacturers are still responsible.[51]

One essential element of the product approval process is determining the target market and the product distribution channels designed, which involves abstractly and generally describing the group of customers whose needs are met. The customer usually belongs to the target market, i.e. in the abstract he/she is the target of the product and, during the advisory and marketing process, is offered the product since it is suited to him/her based on his/her characteristics, situation and needs. However, there may be cases in which the customer does not belong to the target market but, after the profile assessment process, is offered the product.[52] EIOPA considers that the IDD does not prohibit the distribution of insurance products to customers outside of the target market but uses it as something exceptional.[53] The distribution of insurance products outside of the target market is conditional upon an assessment making it possible to verify that the product meets the customer's requirements and needs, as well as its suitability, in the case of investment insurance.[54] It is an exceptional case and, since the IDD is a minimum harmonisation directive, Member States may prohibit the distribution of products outside of the target market.[55] In Spain, distribution is not restricted outside of the target market. The manufacturers may determine a negative market of “specific groups of customers for whom the insurance product is not normally suitable”.[56]

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[49] See paragraphs 31 to 33, art. 10.2 final and the Annex of the IDD; art. 5.4 of Delegated Regulation 2017/2358.

[50] See paragraph 4 of the preamble and art. 3.4 of Delegated Regulation 2017/2358.

[51] Art. 4.5 of Delegated Regulation 2017/2358, which reproduces the provision in EBA guideline 6.

[52] According to the ESMA Guidelines: “When providing investment advice adopting a portfolio approach and portfolio management to the client, the distributor can use products for diversification and hedging purposes. In this context, products can be sold outside of the product target market, if the portfolio as a whole or the combination of a financial instrument with its hedge is suitable for the client.” (Point 52). We consider this criterion to be applicable to insurance distribution, as it is the one that best reconciles customer autonomy and freedom of enterprise with customer protection and market efficiency.

[53] Q&A 1618, available at https://www.eiopa.europa.eu/content/1618_en?source=search. According to the EBA: “The manufacturer should monitor that the products are distributed to the identified target market and sold outside the target market only on a justified basis” (in the European Banking Authority's Guidelines on product oversight and governance arrangements for retail banking products, guideline 7.2).

[54] See paragraph 9 final of the preamble of Delegated Regulation 2016/97.

[55] See Pierpaolo MARANO, “The Product Oversight and Governance: Standards and Liabilities”, in *Distribution of Insurance-Based Investment Products*, 2019, page 88.

[56] Paragraph 8 of the preamble of Delegated Regulation 2016/97. While in the MiFID system there is an obligation to identify “group(s) of clients for whose needs, characteristics and objectives the financial instrument is not compatible” (art. 10.2.1 final of Delegated Directive 2017/593).

The MiFID system is stricter regarding this aspect. It only allows products to be offered outside of the target market for reasons of diversification or coverage.[57] If advice is provided, after analysing the customer profile, the adviser may recommend that the customer contract a product, which is ideal for him/her, even though the customer does not belong to the target market. For example, the manufacturer may have considered that due to the complexity of the product, its distribution is conditional upon provision of advice. However, the distributor may decide, after assessing the customer or specific customer segment, that it is in their best interest for the product to be distributed without advice.[58] In these cases the manufacturer must be informed of the deviation, which may be useful to it in revising the distribution strategy. This criterion also applies to insurance distribution.

However, the Delegated Regulation is categorical: "Manufacturers shall not bring insurance products to the market if the results of the product testing show that the products do not meet the identified needs, objectives and characteristics of the target market".[59] There is a duty to refrain from distributing products that do not meet customers' needs.[60] Only tested products with a positive result may be distributed.

Prior to being distributed to the public, the products designed must undergo testing. By analysing various scenarios through the tests, it must be verified that the product meets the needs of customers throughout its life cycle. The tests must be qualitative and, depending on the product's nature and risks, quantitative.[61]

When there is no testing or a negative test, distribution is legally prohibited. Determining the consequences of distributing products that breach the testing protocol is another matter. Breach of the prohibition is a serious infringement.[62] From a civil perspective, the natural remedy is compensation for the damage caused by infringing the prohibition.

Furthermore, manufacturers have a duty to monitor the products. They must periodically assess whether they continue to be consistent with the customers' needs, taking into account their characteristics, in particular, coverage of risks or guarantees.

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[57] According to ESMA's criterion: "in certain cases, permissible deviations between the target market identification and the individual eligibility of the client may occur if the recommendation or sale of the product fulfils the suitability requirements" (ESMA Guidelines, point 53).

[58] ESMA Guidelines (point 51).

[59] Art. 6.2.

[60] See DE LEÓN MIRANDA, F., "Obligaciones adicionales en relación con la distribución de productos de inversión basados en seguros" in BATALLER GRAU, J. and QUINTÁNS EIRAS, Mª R. (Editors), *La distribución de los seguros privados,* Marcial Pons, 2019, page 649.

[61] EIOPA highlights the relevant aspects that must be taken into account when performing tests: "assessments of the working of the product, the price and coverage of the product, the performance of the product, the risk/reward profile of the product and the product information given to customers". It provides some illustrative examples in relation to investment insurance: "Events like declining stock prices should be identified and the effect on the outcomes of the product should be analyzed". Q&A 1619, available at https://www.eiopa.europa.eu/content/1619_en?source=search.

[62] According to art. 192.3.b) of RDLey 3/2020, it is very serious if it is repeated [art. 192.2.b)].

When inconsistencies are detected, which may negatively affect customers, mitigating measures must be adopted and the affected persons must be informed.

Product governance requires ongoing collaboration between manufacturers and distributors. Their strategies must be reconciled. Information must flow between them. Manufacturers must inform the distributors of the target market and the distribution strategy, in particular any circumstance that may give rise to a conflict of interest. Distributors may thus understand the product, understand the target market and identify the customers for whom the product is intended. It is a matter of ensuring that they always act with "with honesty, fairness and professionalism, for the benefit of their customers' interests".[63] In turn, distributors must maintain open communication with the manufacturers and provide them with pertinent information about the sales performed so they can carry out their control function. In addition, they must report any inconsistencies in distribution that may negatively affect the customer without delay.

Manufacturers must monitor whether distributors are complying with the distribution strategy adopted and apply corrective measures when there are deviations. For their part, distributors must periodically review the consistency of the distribution mechanisms with the strategies approved by the manufacturer within the framework of its distribution and conflict-of-interest prevention policies, in order to prevent harm to customers.

## IV. RULES OF CONDUCT IN CUSTOMER RELATIONS

Most of the section devoted to rules of conduct deals with the duties of information and ways of conveying information.[64] As if it were a regulation, the legal text details the pre-contractual information to be provided by the intermediary or insurance undertaking. They must identify themselves, inform whether they are advising and state the nature of the remuneration.[65] It also details the prior information distributors must provide so that the customer may make an informed decision.[66] In insurance other than life insurance, the information must be provided in a "Prior Information Document" produced by the product's designer.[67] Investment insurance must comply with additional information requirements with prevention of conflicts of interest and assessment of the customer

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[63] Art. 17.1 of the IDD.

[64] See PEÑAS MOYANO, M.ªJ., "Obligaciones generales de información" in BATALLER GRAU, J. and QUINTÁNS EIRAS, Mª R. (Editors), *La distribución de los seguros privados,* Marcial Pons, 2019, pages 581-606.

[65] In the terms detailed in arts. 173 and 174 of RDley 3/2020.

[66] In the terms detailed in art. 175 of RDley 3/2020.

[67] In the terms stipulated in art. 176 of RDley 3/2020. Implementing Regulation 2017/1469 of 11 August establishes a format for standardised presentation of the information document, which María Jesús PEÑAS MOYANO has praised due to considering that standardisation is progress in terms of simplicity "which will prevent the customer from getting lost among the data offered and allow him/her to make informed decisions" in "Obligaciones generales de información" in BATALLER GRAU, J. and QUINTÁNS EIRAS, Mª R. (EDITORS), *La distribución de los seguros privados,* Marcial Pons, 2019, page 605.

profile.[68] Apart from product governance, the distributor providing advice must assess the customer's suitability in order to adjust the offer to his/her "risk tolerance level and his/her capacity to bear losses".[69] When there is no advice, it is sufficient to assess its suitability in order to offer a product suited to the customer.[70] Merely providing products categorised as simple without advice is not conditional upon assessing suitability. It is an assessment and warning system similar to that which governs the provision of investment services. The doctrine that has arisen from the abundant litigation concerning financial instruments thus applies, by analogy, to offering insurance.

## V. CROSS-SELLING

Cross-selling of financial products and services is a matter requiring coherence and systematisation. It is a common source of mis-selling. There are also sectoral regulations that affect both product governance and suppliers' conduct in their customer relationships. The foundations of cross-selling regulation are laid down in art. 24.11 of MiFID II. This entrusts ESMA, in cooperation with the EBA and EIOPA, with developing guidelines for the assessment and supervision of cross-selling, indicating which practices should be prohibited, as they go against the principles of conduct. Compliance with this mandate has gone no further than publishing a consultation document.[71] It was argued that there was no legal basis to draw up common guidelines. The European financial authorities have pointed out the inconsistency in the sectoral directives to the European Commission.[72] In its opinion, cross-selling should be regulated as broadly as possible in order to prevent the damage that has been done to confidence in the integrity of the financial system. Faced with the impossibility of progressing towards common

[68] See Francisco DE LEÓN MIRANDA, "Obligaciones adicionales en relación con la distribución de productos de inversión basados en seguros" in BATALLER GRAU, J. and QUINTÁNS EIRAS, Mª R. (Editors), *La distribución de los seguros privados,* Marcial Pons, 2019, pages 607-660.

[69] Art. 181.1 of RDLey 3/2020.

[70] Art. 181.2 of RDLey 3/2020.

[71] *Joint Committee Consultation Paper on guidelines for cross-selling practices*, JC/CP/2014/05, 22 December 2014 available at https://www.esma.europa.eu/sites/default/files/library/2015/11/jc_cp_2014_05_consultation_paper_on_cross_selling.pdf, according to which "cross-selling is the practice whereby firms group, and sell, two or more separately identifiable products or services in a 'package'" (page 9).

[72] ESAs, *The cross-selling of financial products – request to the European Commission to address legislative inconsistencies between the banking, insurance and investment sectors*, 2016 0726, January 2016, available at https://www.esma.europa.eu/file/15028/download?token=je8kRvkO , which states "our preference for having aligned legislative provisions in different pieces of legislation falling in the regulatory remit of different ESAs (MiFID II – ESMA; IMD/IDD – EIOPA; PAD and MCD – EBA) in order to facilitate competent authorities and financial institutions to understand and consistently apply cross-selling guidelines" (page 3).

guidelines, ESMA decided on a sectoral approach under the MiFID system.[73] These ESMA guidelines must serve as criteria for interpreting the cross-selling rules in the IDD.

RDLey 3/2020 transposes the contents of the IDD on packaged and ancillary sales.[74] No additional protection measures are included nor are any specific cases of cross-selling identified that should be prohibited as they harm consumers. The Directorate General of Insurance and Pension Funds is authorised to adopt intervention measures concerning cross-selling of insurance with products or ancillary products, including their prohibition. However, the authorisation extends to cross-selling when the insurance is the ancillary product.

It is a permissive framework, contrasting with the MiFID system, in which sales of insurance linked to ancillary products and services are implicitly allowed.[75] In turn, it is permitted to link the offer of investment services, real estate loans and payment accounts to complementary insurance.[76] In both cases, they are conditional upon product governance with an adequate description of the risks, costs and nature of the transaction.[77]

## VI. CONCLUSIONS

Regulation of insurance manufacturing and distribution through the IDD and its transposition completes the sector's transition towards its financialisation. Up until now, insurance had been regulated in a somewhat unique way compared with banking and investment. The IDD, based on the MiFID system model, regulates the entire life cycle of insurance products as financial products. Insurance shares principles with other financial services. Insurance manufacturers and distributors must act with impartiality and professionalism. The structure of insurance product governance and rules of conduct in their relationships comes from the structure of the MiFID system. EIOPA shares a supervisory convergence with ESMA and the EBA. Within this framework, the Directorate General of Insurance and Pension Funds is taking steps to adapt to the new legal framework and promote a culture of change within the insurance industry. There

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[73] ESMA, *Directrices sobre prácticas de venta cruzada*, ESMA/2016/574 ES, 11/07/2016, available at https://www.esma.europa.eu/sites/default/files/library/2016-574_es.pdf. There are ten guidelines on information about the characteristics of cross-selling and its risks, prices and costs, staff training and the right of cancellation. These guidelines must be updated to the digital context, following ESMA's warning that this is "especially relevant as large technology firms, who are already providing technology services to consumers, enter financial services" (*ESMA's response to the European Commission's Consultation on a New Digital Finance Strategy for Europe*, ESMA50-164-3463, 29 June 2020, pages 3 and 4; available at https://www.esma.europa.eu/sites/default/files/library/esma50-164-3463_esma_dfs_response.pdf).

[74] See Álvaro REQUEIJO TORCAL and Álvaro REQUEIJO PASCUA, *Ley de distribución de seguros y reaseguros privados. Comentarios y soluciones prácticas para distribuidores tras la transposición de la Directive IDD*, Editorial Aranzadi, 2020, pages 337-340, which contains some illustrative examples.

[75] In the terms detailed in art. 184.1 of RDLey 3/2020.

[76] In the terms detailed in art. 184.2 of RDLey 3/2020.

[77] In the terms detailed in art. 184.4 and 5 of RDley 3/2020.

are basic issues, such as acting in the customer's best interest, that must still be assimilated. Insurance is a financial service that is provided in the customer's interest to meet his/her needs. There is no opposition of interests.

The new framework for insurance distribution is administrative but also has contractual relevance. A reform of the Insurance Contract Act has been imposed in order to adapt it to the governance and conduct framework arising from the IDD. This legal change has come at a time of digital transformation of the financial system. The Fintech perspective, which combines offering diverse financial services through platforms, is promoting the necessary harmonisation of rules of conduct and contributes to overcoming silo-based regulation and supervision. In turn, harmonisation and systematisation of the rules of conduct aids the digital transition.

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