GIBRALTAR FINANCIAL SERVICES COMMISSION

Insurance Distribution Directive

Product Governance and Distribution channels

Examples of good and poor practice

Contents

Introduction....3
The aims of the paper .... **Error! Bookmark not defined.**
Explanatory notes....3
Product Governance....4
Product Governance for Intermediaries 5
Co-Manufacturing 6
Target Market....7
Distribution....8
IDD Preparedness....10

Introduction

The Insurance Distribution Directive (IDD) was implemented in Gibraltar via the Financial Services (Investment and Fiduciary Services) Act. The Gibraltar Financial Services Commission (GFSC) has considered and assessed the new requirements introduced by the Directive and has held several discussions with industry participants in respect of IDD's key features; product governance and distribution channel requirements.

The EU has issued specific requirements in respect to product governance and distribution channels set out in REGULATION (EU) 2017/2358 ("Regulations") with regard to product oversight and governance requirements for insurance undertakings and insurance distributors.

The GFSC makes reference to these Regulations, particularly the Recitals in the Regulations. Nonetheless, firms should familiarise themselves with the Regulations in their entirety.

This paper aims to set out the GFSC expectations in respect of product governance and distribution channel requirements.

The GFSC has discussed the approach to meeting product governance and distribution channel requirements as set out in the IDD with Insurance entities in order to establish what is considered "*best and poor practices*". Examples are set out below in a practical manner to help set out the GFSC's expectations for firms to ensure compliance with the Directive's requirements. The aim of setting out these examples is to provide an understanding of our expectations. It should be noted that this is not an exhaustive list of examples or scenarios and the onus remains the firms' to ensure compliance with the requirements and that the GFSC's expectations are being met.

Some examples may be more relevant to some types of business than others and these should therefore be considered accordingly.

Explanatory notes

It is expected that in anticipation of the implementation of IDD, firms will have established the relevant committees, processes and policies to ensure compliance with the requirements once the regulation comes into force. It is the GFSC's expectation that firms are fully compliant with the requirements from implementation date.

Terms used in this paper in respect of Committees are only examples. The aim is for a firm to have in place a formalised approach within its structure to ensure compliance with the requirements for product governance and distribution channels. This does not mean that it would be expected that a new committee is put in place, the new set of responsibilities brought in by IDD could be incorporated into an existing committee. For ease of reference, the paper refers to product oversight committee.

At this stage evidence that as a firm is being proactive in requesting and obtaining this information is expected

Product Governance

As per Chapter II of the Regulations, Manufacturers shall maintain, operate and review a product approval process for newly developed insurance products and for significant adaptations of existing insurance products.

Examples of best practice:	Examples of poor practice:

• Product oversight committee in place. The expectation is for the function as set out in the Regulations to fit into the governance structure, with terms of reference and product review cycle that will fit into the structure of the firm. This should also include clear responsibilities. To note that this can be an existing committee that is made responsible for this, it does not need to be a new committee.
• Governance structure: with clear roles and responsibilities and clear rules on chairing.
• The feeding/reporting lines from the different parts of the business such as the product development team, underwriting team, conduct etc. to the product oversight committee are clearly set out.
    ○ Get information on providers and put all that information together, e.g. underwriting and have staff members attending key committees to get insights. Provide and receive updates to ensure on track.
    ○ Internal systems are adequate for the size of the business, and the type of distribution to ensure that oversight is maintained on the way the product is being marketed and sold.
    ○ Provide and receive updates from different parts of the business to the product oversight committee on the product to ensure that it's on track.
    ○ Reporting lines are robust ensuring that decisions are not being made in silos.
• Oversight and upward reporting of the product oversight committee – some good examples seen include:
    ○ Other committees have oversight of the product, adding flexibility when required
    ○ The approach must be approved by the Board of Directors.
    ○ A Director is appointed as being responsible for product oversight.
• Good MI used to design, develop, review and approve products to ensure fitness validation of the product.
    ○ Complaints – good record keeping and approach, as well as monitoring of these.
    ○ Claims data
    ○ Retention data
    This will be proportional to the product and complexity. Some may have the statistics broken down by broker. MI will be needed for each of the products insurers have.
• Ongoing oversight structure in place.
	• No responsibility for product oversight allocated, e.g. no product oversight committee
	• Insurers not taking the responsibility of being a product manufacturer and trying to put responsibility onto introducers or co-insurers.
	• Compliance function not having any type of oversight such as records of minutes' attendance or minutes of the product governance committee. Not having a structure in place to see that some areas are covered in product oversight.
	• Not using statistics to aid in product development. E.g.
	    ○ Lack of complaint monitoring and record keeping to be able to follow patterns and trends to help to improve the product.
	• No consideration of suitability of the product to the needs of clients when designing and developing the product.
	• Not producing KID/IPID on a timely manner.
	• Making the broker responsible for the product allocation to clients without having enough oversight to ensure that the product is right for the customer.

Product Governance for Intermediaries

Chapter III of the Regulations sets out specific Product Governance requirements for Insurance distributors.

Examples of best practice:	Examples of poor practice:

• In some cases, product development is undertaken by intermediaries on behalf of insurers for whom they act. In such cases, the intermediaries involved are responsible for taking customers' interests and needs into account in performing this work. Nevertheless, the insurer retains oversight of, and remains accountable for, the development of its products and its distribution strategies.
• As per recital 11 (of the Regulations), insurance distributors should provide manufacturers with the data needed for the review of the insurance product, in line with the information requested by the insurer.
• The Distributor will check that the products it is selling remain in line with the needs, characteristics and objectives of the target market identified by the manufacturer.
• Providing information to insurers in a timely manner.
• Having an appropriate product selection processes to ensure that products are designed and promoted to be suitable to the needs of target markets. For example, an assessment of new products or amendments to existing products to understand the different aspects and risks and ensuring that it fits in with the customer base of the firm. Furthermore, the role out of adequate training to staff.
• Providing robust training for staff to ensure that they have the correct knowledge and understanding to sell the right product to the right customer.
	• The intermediary not understanding products and not understanding how they meet needs of their clients.
	• Not having a product approval process in place.
	• Documents not being sent by the insurer in a timely manner and the intermediary not following this up.
	• Data and information not being provided by the intermediary to the insurer in a timely manner, therefore, not enabling the insurer as manufacturer to make any necessary amendments to the products.
	• Not providing training on products to sales staff.
	  ○ Example for general insurance: Sales staff not understanding that travel insurance policy does not cover individuals with heart conditions.
	  ○ Excesses not being explained to customers correctly.
	  ○ Selling insurance products to customers that the customers do not require.

Co-Manufacturing

As per recital 4, of the Regulations where an insurance product is designed and developed by an insurance intermediary and an insurance undertaking acting together with both of them having a decision-making role in designing and developing that product, the insurance intermediary and the insurance undertaking should specify in a written agreement their collaboration and respective roles so that competent authorities are able to supervise compliance with the legal requirements.

This means that in instances where the insurance intermediary or co-insurer holds some of the decision making powers with regards to the designing and development of the product, they are co manufacturers with the insurance undertaking.

Examples of best practice:	Examples of poor practice:

• Co-Manufacturers – written agreement is in place setting out the responsibilities and obligations of each party in areas such as
  ○ Product development, decision making and including details of clear communication lines between all parties.
• Established a joint team between insurer and co-insurer or distributor to ensure approach is consistent and, decision making on products is aligned, between all parties. This is something that is considered beneficial.
  ○ For example, a firm is a small part of a co-insurance arrangement which they entered into 10 years ago, they do not have a lot of say on the product and the main insurer has not developed substantially in its corporate governance style. The firm documents and flags any areas and ensures that it is comfortable with the changes being made by the Product Governance Committee. The firm needs to ensure that it has the right structure in place and document what is done to raise issues and how it satisfies itself that they are comfortable with the decision being made.
• Maintaining good working relationships between co manufacturers (be it co-insurers or intermediaries) to ensure that the relevant people can effectively work together.
• Joint policy review and approved by the two parties in place.
	• No agreements in place setting out responsibilities and obligations of each of the parties.
	• No clear communication lines
	• No joined up approach to product manufacturer.
	• Not having meetings in place to coordinate on decision making. Consequently, this will be shown as a lack of oversight.

Target Market

As per recitals 5 and 6 of the Regulations, where the identification of the target market by the manufacturer should be understood as describing a group of customers sharing common characteristics at an abstract and generalised level in order to enable the manufacturer to adapt the features of the product to the needs, characteristics and objectives of that group of customers.

It should be distinguished from the individual assessment at the point of sale to determine whether an insurance product meets the demands and needs and, where applicable, whether an insurance-based investment product is suitable or appropriate for the individual customer or potential customer. The level of granularity of the target market and the criteria used to define the target market and determine the appropriate distribution strategy should be relevant for the product and should make it possible to assess which customers fall within the target market. For simpler, more common products, the target market should be identified with less detail while for more complicated products or less common products, the target market should be identified with more detail taking into account the increased risk of consumer detriment associated with such products.

Examples of best practice:

- Consider objectives, demands and needs of the target market.
- Clear documented process for establishing the target market of the business.
- Establish a clear target market, with defined parameters of type of customer product would be suitable and appropriate for.
- Analysis of target market data from internal data sources and other distributors in the chain.
- In respect of identifying target markets, in particular with regards to insurance-based investment products, manufacturers can identify specific groups of customers for which the insurance product is typically not appropriate.
  For a general insurer market segmentation attached to the type of product: Target market mature drivers with no claims in rural areas in the UK. Some firms may have wider target markets than that set out in the example, and as long as it is relevant to the product it can, for example, be to target all UK drivers. For complex products - Expectations for more significant disclosure regime than for other types of business.
- Having information and controls in place at both insurer and intermediary level to discourage the wrong allocation of the product to customers particularly when dealing with vulnerable customers.

Examples of poor practice:

- Lack of thought process in determining the target market and little or no thought as to the needs of the customer and suitability of the product
- Lack of assessment of customers to establish if business is attracting the expected target market.
- Having complex products and not considering the higher risk these pose compared to less complex products.
- Lack of consideration of the complexity of the product to the target market and no supporting documentation and literature provided when dealing with less sophisticated customer groups.
- Lack of a defined target market (depending on the type of insurance).

Distribution

As per recital 9, to ensure appropriate information and advice for customers, manufacturers should select insurance distributors that have the necessary knowledge, expertise and competence to understand the features of an insurance product and the identified target market. For the same reason, they should, within the framework of applicable national law governing their relationship with the insurance distributors in question, monitor and examine on a regular basis whether the insurance product is distributed in conformity with the objectives of their product oversight and governance arrangements and take appropriate remedial action where they consider that that is not the case. This should, however, not prevent insurance distributors from distributing insurance products to customers who do not belong to the identified target market, provided that the individual assessment at the point of sale justifies the conclusion that those products correspond to the demands and needs of those customers and, where applicable, that insurance-based investment products are suitable or appropriate for the customer.

As per recital 10, to enable insurance distributors to fully understand the products they intend to distribute, in order for them to carry out their distribution activities in accordance with the best interest of their consumers, in particular by providing professional advice, manufacturers should provide insurance distributors with all appropriate information on insurance products, including on the product approval process, the identified target market and the suggested distribution strategy. Conversely, insurance distributors should have arrangements to obtain the required information from the manufacturers in an efficient manner.

According to recital 12, to avert the risk of customer detriment, manufacturers and distributors should take appropriate action when they consider that the product is not or no more aligned with the interests, objectives and characteristics of the identified target market.

Examples of best practice:

Selecting distribution channels

- For new products or relevant amendments, have an approach for identifying and assessing distribution channels. E.g.
  Distributors' knowledge and understanding of the product; including:
    - familiarity with the product type;
    - understanding of the complexity of the product
    - any necessary training or materials
    - ongoing oversight of distribution
- Good process for oversight of documentation, explaining the product to intermediaries. This being thorough, detailed and covering significant risks and issues.
- Before an insurer or intermediary promotes an insurance product, it should take reasonable steps to ensure that the information provided is accurate, clear and not misleading. Procedures could provide for an independent review of promotional material intended for customers other than by the person or organisation that prepared or designed it. For example, where promotional material is developed by an intermediary on behalf of an insurer, the insurer should verify the accuracy of promotional material before it is used.

Oversight of distribution channels

Examples of poor practice:

- Not using MI to assist in overseeing distribution channels e.g. Collection and analysis of complaints data from internal data sources and other distributors in the chain.
- Limited oversight of agents, with no audits no specific information on them, and no collation of MI.
- Not considering that distribution channels may have vulnerable customers and looking at ways of mitigating this risk. This is particularly important if an insurer or intermediary whose business model targets customers in low income, unsophisticated segments or with relatively low financial capability, are expected to take more extensive steps to mitigate risks than insurers or intermediaries operating in less vulnerable customer segments.

- You may rely on the fact that an intermediary can be regulated, however, the insurer still needs to consider MI e.g.
    - Review of complaints to establish root causes.
    - Review of cancellations to highlight themes.

  Other factors such as whether on exchanges with the intermediary it is clear that the product is understood. The expectations on this will be dependent on the complexity and size of the distribution channel. Furthermore, it may be necessary for those with more complex and large distribution channels to have a more structured approach with resourcing or a system to assist in the process.
- Use of broker panels to oversee distribution channels.
- Mystery shopping to assess selling practices.
- Onsite visits of distributors.
- Thorough approach for the review of IPID/PRIIP and its onward distribution.
- Good use of informal relationships with distributors
- Internal audit covering onsites of intermediaries covering their approach and application of IDD principles into selling the product as per its PRIIP. Internal audit review of the distribution channels, to ensure these adhere to the insurer's policies.

- The requirement to provide oversight extends through all links to the point of sale.

Life insurance and vulnerable customers

- Life insurers have a very clear authority to distribution channels and oversight of this.
- For life insurers: Considering controls in place to help mitigate risk of type of distribution model used, such as quality and suitability of product disclosures, controls over quality of advice, availability of "cooling off" periods etc.
- Where an insurer or intermediary serves customers across a range of types with different levels of financial capability, the range of products, distribution channels and customer service processes may need to be adequately differentiated to suit the needs and capability of the different types of customer groups.
- When intermediaries that a firm enters into arrangements with, also use intermediaries a firm will need to ensure that its risk appetite is maintained and that the agreement between the insurer and the intermediary caters for the underlying intermediaries and the oversight of these. MI is also key to this example.

IDD Preparedness

Examples of best practice:	Examples of poor practice:
• Having an advisor or someone senior internally to conduct an independent review on current approach and way to make this IDD compliant. A need to properly consider the IDD requirements and changes needed. This may require revisiting policies and reviewing approach to IDD. Have Board engagement in the process. • Training across all areas of staff on IDD in respect of awareness and understanding of the directive and its impact on the business. This is separate to the knowledge and competence requirements but to assist in appropriate IDD implementation all staff need to be aware of how the requirements affects them. For example, Underwriters need to know how they fit into product governance processes. • Establishment / redefining of all the relevant committees and the applicable Terms of Reference. • Review of internal policies and processes to ensure these are IDD compliant.	• Not conducting an analysis of new requirements, including underlying Regulations and establishing how to be compliant. • Not considering the appropriateness of the products to the existing target market • No amendments to internal policies and processes where these are not IDD compliant

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