MARSH

Adviser

Are you ready for more regulation? The Insurance Distribution Directive

Having just grappled with General Data Protection Regulation (GDPR) implementation, law firms conducting insurance mediation activity need to be aware that additional regulation, the Insurance Distribution Directive (IDD), relating to that activity came into force on 1 October, 2018.

Solicitors Regulatory Authority (SRA) has also published an updated Handbook and ethics guidance reflecting the changes for law firms they regulate: https://www.sra.org.uk/solicitors/handbook/finserconduct/content.page http://www.sra.org.uk/solicitors/code-of-conduct/guidance/guidance/law-firms-carrying-on-insurance-distribution-activities.page

The new directive introduces significant obligations on all businesses involved in insurance distribution. The requirements are intended to harmonise standards across Europe, and create a more level playing field in the quality and transparency of information provided to buyers of insurance.

Am I affected?

Litigation, personal injury, and property are typical areas where law firms are involved in insurance activity that requires them to be regulated, either as an Exempt Professional Firm (EPF), or directly regulated by the Financial Conduct Authority (FCA) for that activity (a route a few have chosen).

IDD affects all such law firms. Most law firms are now on the EPF register, which is maintained by the FCA, but that wasn't always the case: numbers increased a few years ago after firms were asked by the SRA to confirm their activity in this area. The SRA's interest may have brought home the obligations associated with being an EPF to the many firms who were previously unaware. These firms will now have to adapt procedures again in order to meet the new SRA Handbook requirements and ethics guidance.

What do I have to do?

SRA has published the rule changes for law firms in detail as set out above. The focus is consumer protection, and some of the rules do not apply to larger commercial clients and specific insurance contracts.

If not completed already, the key things firms will need to do are now governed by the amendments to Rule 9 SRA Financial Services (Conduct of Business) Rules 2001 and the detailed requirements in Appendix 1. Summarising, these are as follows:

1. **Communications** – all marketing information must be clear, fair, and not misleading.
2. **General information** – in good time before the transaction, a firm must confirm:
    - A. **If it provides a personal recommendation in relation to the product.**
    - B. **Complaint and redress procedures.**
    - C. **Whether the firm acts for the insurer or the client.**
    - D. **Financial interest in a relevant insurer.**
    - E. **If an Insurer has financial interest in the firm.**
3. **Service scope -**
   3.1. In good time before conclusion of the transaction:
    - A. Where giving a personal recommendation, confirm whether this is on the basis of a fair and personal analysis.
    - B. Confirm if contractually tied exclusively to a particular insurer, which must then be named.
    - C. If not tied contractually to an exclusive, and not giving advice on a fair and personal analysis, then confirm the names of insurers with which the firm may or does do business.
4. **Demands and needs** – a document setting these out must be given to the client based on information from the client. Any insurance must be consistent with meeting the client's demands and needs. If there is a personal recommendation, an explanation of why the particular contract meets those needs must be given.
5. **Use of intermediaries** – any used need to be registered in a European Economic Area (EEA) state for IDD purposes, unless business is outside EEA. Before using them, firms must check the Financial Services Register, or home state regulator to ensure intermediary is properly authorised.
6. **Treating complaints fairly** – additional obligations to ensure complaints from non-clients are registered and answered.
7. **Remuneration** – must be in the client's best interests; firm and employees are not to be remunerated in a way that conflicts with duty to act in client's best interest.
8. **Remuneration disclosure** – fees commissions or any financial benefit must be disclosed.
9. **Fee disclosure** – all fees in the policy lifetime, must be disclosed up front where possible or otherwise the basis for calculation must be disclosed.
10. **Means of communication to clients** – paper is the norm, durable media can be used where appropriate and with the client's consent, and for websites additional requirements and obligations to provide paper copies free of charge.
11. **Cross-selling requirements** – where insurance is the ancillary product, separate description, pricing, and confirmation is needed if products can be bought separately (or with any difference in coverage), and an option to do so must be provided (save for investment, credit, or special payment accounts).
12. **Professional and organisational requirements** – the firm and each relevant employee possesses appropriate knowledge and ability and are of good repute, as well as all the persons in its management structure and any staff directly involved in insurance distribution activities.
13. **Information for clients** – specific requirements on policy and information to be provided so that an informed decision can be taken in good time before conclusion of the policy must be provided; for individuals acting outside their trade or profession, an Insurance Product Information Document (IPID) must be provided. For products they distribute, firms must also have access to insurer information about the products, their design, approval and target markets.
14. **Exclusions for large risks** – paragraphs 2,3,4,7,8,9,13 do not apply to various defined larger business risks.

What is the risk?

Law firms generally may be aware that failure to comply with similar obligations in financial services has been a significant source of risk in the past. Involvement in endowments linked to mortgages, pension selling, and drawdown schemes created significant losses, which professional indemnity insurers often covered.

As some will know – to their cost – failures in record keeping were often fatal to defending such claims. Historically, the Financial Ombudsman Service often awarded compensation in favour of a claimant if documentation recording the following could not be found on a file:

- Client demands and needs.
- Key facts.
- Reasons why.
- Attitude to risk.

While the proposed rules appear eminently sensible in order to achieve the aims of transparency and a level playing field, demonstrating compliance with clear audit trails will require significant changes to processes and documentation for some firms involved in the area. Implementing necessary changes and achieving a demonstrably high standard is likely to involve significant monitoring and management effort.

What is the regulatory position?

Hopefully, most firms are ready – SRA launched a consultation on meeting the IDD requirements, which is now closed, and has provided updates on how it is changing its rules to meet the directive. SRA also outlined what EPFs needed to undertake ahead of the Directive application date on 28 June, 2018, at http://www.sra.org.uk/sra/consultations/insurance-distribution-directive.page#download

- **Assess whether any changes will need to be made to their processes** to comply with the proposed rules.
- **Review their approach to their communications** encouraging clients to use them to inform their decision making process.
- **Consider how they can make information meaningful to clients** and make sure that information is provided at an appropriate time and through the right channels.
- **Think about any learning and development to remain competent** and consider the impact of the IDD on how they conduct business.

As mentioned, the SRA Handbook and guidance has now been updated.

What does all this mean?

Some firms we have spoken to in the last few months were well prepared, but others were not aware of these new obligations. Given the obligations and the effort involved in complying, some firms may also be taking the strategic view that this is not core to the business, will absorb effort, and will generate disproportionate risk. Larger businesses with infrastructure and support should not find the changes too difficult, but smaller firms, depending on their structure and resources, may well find that the risk, return, and effort do not justify continuing involvement in these activities.

Firms requiring assistance, or with any queries on these or other issues should get in touch with their normal Marsh contact.

This is a marketing communication.

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