Redefining Product Management: IDD's Perspective

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1 Introduction

It should not come as a surprise that it is only possible after a certain period of time to assess legal acts which revolutionized a given area of law. In order to do so, a practice of application of legal provisions needs to be established, first decisions of national courts and governing authorities have to be made and the legal doctrine needs to be formulated. Although, three quarters have already passed since the date of implementation of Insurance Distribution Directive ('IDD'),¹ it is still definitely too short to determine whether or not the desired objectives have been achieved. It is however the right moment to give pause for thought about both the promises that the IDD held and disappointments, which it eventually brought.

This chapter discusses the issue of product governance—one that the IDD has redefined. In particular, the requirements of product oversight and governance introduced in the Article 25 of the IDD and further developed in the Commission Delegated Regulation supplementing Directive (EU) 2016/97² with regard to product oversight and governance requirements for insurance undertakings and insurance distributors will be analyzed ('**Delegated Regulation**'). Regarding this, the author

¹Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (Official Journal of the European Union L 26/19).

²Commission Delegated Regulation (EU) 2017/2358 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to product oversight and governance requirements for insurance undertakings and insurance distributors (Official Journal of the European Union L 341/1).

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will focus on three key concerns. Special attention will be drawn to the process of identifying target market with respect to each product, assessment of all relevant risks to such identified target market as well as to the assessment of consistency between the intended distribution strategy and the identified target market. Undoubtedly, a formal recognition of the possibility to manufacture insurance product by the insurance intermediaries and providing them with specific obligations resulting from such possibility is an important breakthrough. So far, even in case of the so-called 'brokerage programs', i.e. products created individually by brokers, obligation and liability have been attributed to the insurance companies offering insurance coverage under the brokerage programs. Against this background, it is worth wondering whether the insurance intermediaries will be interested in being 'manufacturers' and entering contracts stipulating detailed conditions of cooperation with the insurance company in accordance with the requirements for the manufacturers, referred to in the Article 3 sec. 4 of Delegated Regulation. Another issue, which should be addressed, is the admissibility of concluding such contracts between the insurance companies and brokers. This regards specifically those countries where a permanent cooperation between insurance company and broker is not practiced or forbidden. Since the IDD has been implemented into the national legal systems, product governance is no longer subject to the internal arrangements of the insurance company nor European or national soft law. Currently, product governance regulation constitutes part of the binding laws thereby it is possible to impose sanctions in case of its violation. The analysis of the shift in the approach to the product governance and its impact on the insurance companies, intermediaries and insurance market will be presented in the last part of this chapter.

2 IDD as a Response to the Needs of the Market

Not only was the aim of the IDD to adjust the current intermediation regulations to a rapidly changing technological and legal environment, but most importantly it was to ensure high level of customer protection (as a "weak part" of market³) among all the distribution channels. The objectives were directly expressed in the IDD's recitals. For instance, according to the recital 6 consumers should benefit from the same level of protection despite the differences between distribution channels, whereas recital 16 indicates that this Directive should ensure that the same level of consumer protection applies and that all consumers can benefit from comparable standards. Application of the uniform standards is believed to be beneficial not only for customers but also for distributors by promoting a level playing field and competition on equal terms between intermediaries, whether or not they are tied to an insurance companies (recital 16). Both insurance companies and intermediaries have been obliged to take on new obligations, which also involve costs. Introduction

³Schaeken Willemaers (2014), p. 2.

of uniform obligations for all the distributors is justified with the principle of equal treatment of economic operators.

It is difficult not to agree with the IDD that it is beneficial for customer to have insurance products distributed via different channels and by intermediaries cooperating in various forms with the insurance companies, provided they are obliged to comply with the similar customer protection rules. Nevertheless, it is reasonable to voice a concern of whether it is similarly beneficial for distributors. So far, the obligations related to product governance constituted a regulation of soft law nature and were imposed on the insurance companies. Therefore, insurance intermediaries do not have in place any proceedings standards or qualified staff in this field. It thus remains an open question whether a uniform regulation will translate to its uniform application. It goes without saying that distributors cannot be treated equally with the insurance companies in terms of their financial, personal and economic background. Consequences of the unification of obligations will be further examined in part 6 of this chapter.

3 Definitional Problems

European insurance market faced a bunch of challenges raised by the IDD, among which introduction of new terminology, which is considerably different from the traditional insurance contract approach presented in the civil code. Further to this, a lot of terms used by the European legislator are not defined or are used synonymously, which results in blurring the distinction between their original meanings.

From the author's point of view, lack of the definition of insurance 'product' as well as lack of further explanation of what does it mean to govern such product is particularly harmful.

The way of using term of 'insurance product' within the IDD clearly indicates that it is associated with the insurance contract. This conclusion results from recital 10 of IDD which states as follows: *it is important to take into consideration the specific nature of insurance contracts in comparison to investment products regulated under Directive 2014/65/EU of the European Parliament and of the Council. The distribution of insurance contracts, including insurance-based investment products, should therefore be regulated under this Directive and be aligned with Directive 2014/65/EU.* Based on this, the insurance product should be interpreted through the prism of the insurance contract understood as a general type of contract that can be concluded by the insurance company—not as a specific insurance contract concluded with an individual. Shortly after the adoption of the IDD, a dispute over the meaning of the insurance product raised. Some claimed that it should be understood as a 'contract' offered to an individual client, while others argued that 'product' means 'conditions' on the basis of which the insurer concludes individual contracts. In order to solve this dispute, not only linguistic interpretation (noteworthy is the inconsistent use of terminology by the European legislator), but also systemic interpretation of the regulation should be taken into consideration. The

author claims that the most important argument against defining product as a contract offered to an individual client is the requirement to distribute the product to the identified target market (provided for in both IDD and Delegated Regulation)—this term alone refers to the multitude of actors.⁴ Following on from this argument, the insurance product should be understood as insurance contract's conditions, which stipulate right and obligations of each of the contracting parties. Thus, identification of the insurance product should be easy, as it would be based on the number of a specific management board's resolution, which adopted the insurance contract's conditions.

However, understanding of the term 'product' should not be limited exclusively to the insurance contract's conditions adopted by the management board's resolution. Rather than formalization, it is the repeatability of application of given provisions, which is of more importance. In the light of the IDD provisions, status of the insurance product should be attributed also to the 'templates', clauses and additional provisions which are or may be applicable as a standard (i.e. they are not subject to negotiations) to a particular type of insurance contract and which comprehensively regulate the insurance relationship or the framework in which it can be shaped.⁵ This approach though poses the risk of lack of prior identification of the insurance product by the insurance company. This is because the insurance companies predominantly use framework offers (so-called 'insurance programs' or 'dedicated offers') dedicated for customer groups which are not individually negotiable at the level of the insurance contract, and at the same time they are not adopted by the management board's resolution. Bearing in mind the above, it is out of doubt that the said 'insurance program' should be considered the insurance product.

Since the IDD—and national regulations accordingly—provides for the obligation to undertake certain actions with respect to the products, failure to identify the 'template' or 'program' as product may lead to violation of obligations related to the product governance. This, in turn, could be followed by the sanctions imposed by the relevant supervisory authority.

As in the case of 'product', no definition of 'product governance' has been provided by the IDD. It can be though formulated on the basis of the Article 25 of the IDD. The manufacturer is required to have in place a process, which allows to manufacture products and amend them in a conscious manner. Pursuant to the Article 25 the obligations related to product governance are divided into two groups: (i) obligations that should be fulfilled before the product is marketed ('within the process of approval') and (ii) obligations that arise in the course of the product's life. Governance issues are further developed in the Delegated Regulation which specifies that the manufacturers designating a third party to design products on their behalf shall remain fully responsible for compliance with the product approval process (Article 4 sec. 5).⁶

⁴Kwieciński (2018), p. 166.

⁵Nawracała (2019), p. 61.

⁶Marano (2019), pp. 69–70.

The first group of obligations includes specification of an identified target market for each product, ensuring that all relevant risks to such identified target market are assessed and that the intended distribution strategy is consistent with the identified target market. In addition, the manufacturer is obliged to take reasonable steps to ensure that the insurance product is distributed to the identified target market. Therefore, the European legislator expects the manufacturer to take specific actions, instead of mere planning.

Delegated Regulation repeats most of the abovementioned obligations and supplements them by introducing the requirement to test the insurance products before bringing them to the market, including scenario analyses where relevant. Such analyzes include assessment of the imaginary state of the future,⁷ while their purpose is to simulate functioning of the product under changed operating conditions, i.e. high inflation, economic crisis, etc. It seems though that the scenario analyses should be applied only to the products of sufficiently high time horizon, e.g. to the investment-based insurance products.

After having brought product to the market, it is crucial for the manufacturer to regularly review that product, taking into consideration all the events that could materially affect potential risk for the identified target market. The insurance product may become no longer consistent with the needs of the identified target market due to the external changes, independent from the product itself. Likewise, the distribution strategy adopted at the time of marketing the product may become no longer appropriate. Lack of consistency may result from e.g. changes to the legal regulations (introduction of new legal acts, changes to court jurisprudence), economic or social situation among the target customer group. The frequency of regular reviews is determined by the manufacturer, however, while taking such decision size, complexity, scale of the reviewed products as well as current developments (legal, economic, technological) should be taken into account.

Another obligation of the manufacturer is to make available to distributors all appropriate information on the insurance product and the product approval process, including the identified target market of the insurance product. Although, the importance of providing information on the insurance product is clear and fully justified (distributor should be aware of the product's functioning in order to not mislead the client), certain doubts raise with respect to the amount of information on the product approval process which distributor should receive. Namely, the product approval process is an internal process of the insurance company, thereby it remains confidential. Therefore, information having a direct impact on the distributor (what is the identified target market and distribution strategy), should be distinguished from the information which is irrelevant to the distributor (who is involved in the process of manufacturing the product, what is the division of competencies). It seems safe to say that the mentioned distinction is somehow reflected in Delegated Regulation. Article 8 of Delegated Regulation indicates types of information to be provided to the distributors as well as the purposes of that provision: understanding

⁷Kwieciński (2018), p. 171.

the insurance products by the distributors, comprehending the identified target market, identifying clients for whom the insurance product is not compatible and carrying out distribution activities in accordance with the best interests of the client.

Furthermore, Delegated Regulation sets out certain obligations which should be fulfilled within the product's life cycle by the distributors who are not manufacturers. Pursuant to the Article 10 of Delegated Regulation, distributors should have in place internal procedures to obtain from the manufacturer all appropriate information on the insurance products and to fully comprehend those insurance products. Any specific distribution strategy set up or applied by distributors should not be in contrary to the distribution strategy set up and the target market identified by the manufacturer. Moreover, it should be ensured that the distributors regularly review their product distribution strategy, particularly by verifying whether the insurance products are distributed to the identified target market. In turn, to support product governance carried out by manufacturers, distributors should upon request provide manufacturers with relevant sales information. However, provision of sales information should not be recognized as an obligation to disclose the results of total sales, client lists, etc. By contrast, sales information may include the assessment of consistency between the product and identified target market (i.e. whether the clients being target group are interested in the product) as well as information on what are the target group clients' needs which are not met by the product. Obviously, the purpose of the exchange of information between manufacturer and distributor is to ensure product's consistency and customer protection against misselling.⁸

The product approval process referred to in the Article 25 of IDD should be proportionate and appropriate to the nature of the insurance product, while product oversight and governance measures should be chosen and applied in a proportionate and appropriate manner. There are also products to which the above describe process does not apply. This exemption pertains to the insurance products which consist of the insurance of large risks (Article 25 sec. 4 of IDD).

Notion of large risks has been introduced by Solvency II Directive⁹ and it means risks classified under classes 4, 5, 6, 7, 11 and 12 in Part A of Annex I (i.e. railway rolling stock insurance, aircraft insurance, ships insurance, insurance of goods in transit, including merchandise, baggage, and all other goods, aircraft liability insurance and liability for ships insurance respectively). Large risks status is also attributed to credit insurance and suretyship insurance (classes 14 and 15 in Part A of Annex I respectively), where the policyholder is engaged professionally in an industrial or commercial activity or in one of the liberal professions and the risks relate to such activity. Lastly, risks classified under classes 3, 8, 9, 10, 13 and 16 in Part A of Annex I (land vehicles insurance, except for railway rolling stock, fire and

⁸About misselling see also: Ferran (2012), pp. 247–270; Subashini and Velmurugan (2016), pp. 264–267.

⁹Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (Official Journal of the European Union L 335/1).

natural forces insurance, other damage to property, motor vehicle liability insurance, general liability insurance and miscellaneous financial loss insurance respectively), can be considered large risks, in so far as the policyholder exceeds the limits of at least two of the following criteria: (i) a balance-sheet total of EUR 6,2 million; (ii) a net turnover, within the meaning of Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies (30), of EUR 12,8 million; (iii) an average number of 250 employees during the financial year.

Certainly, introduction of the category of large risks is of great importance for the risks classified under classes 4, 5, 6, 7, 11 and 12 in Part A of Annex I. With respect to these risks, the IDD exempts not only from the requirement to maintain product governance system, but also from the obligation to prepare documents such as IPID.

In turn, as to the most common property insurance (particularly risks classified under classes 8, 9, 10 and 13), large risks definition is understood through the prism of policyholder. This is, the risk can be classified as a large risk only at the moment of conclusion of individual insurance contract as only at this time it is possible to verify whether the policyholder exceeds the limits of at least two of the three abovementioned criteria. It also means that the insurance company is required to adopt the process referred to in the Article 25 of the IDD and Delegated Regulation with respect to these products, unless it identifies target group clients excluding individuals who do not fulfill the above requirement, which seems unlikely. It is also necessary to prepare standardized insurance product information document. Legal doctrine welcomes and justifies the exemption of the insurance companies from the obligations related to product governance in cases where the insurance contract is negotiated, and insurance conditions serve only as a starting point for the dialog between insurance company and policyholder. However, the same arguments cannot be applied to the risks classified under classes 8, 9, 10 and 13. With respect to these risks, regardless the degree of insurance contract individualization, the insurer will not be exempted from the abovementioned obligations due to the fact that it is possible for the insurer to conclude the insurance contract with an individual or entity which do not exceed the limits of at least two criteria referred to in the Article 13 point 27(c) of Solvency II directive. The author claims that it is not reasonable for the IDD to use the term of large risk as a measure to enhance protection of the policyholder¹⁰ (which also reflects the tendency of the protection regime to embrace entities other than consumers¹¹). It is customer protection which should be an overreaching aim of the IDD and delegated regulations rather than protection of entities benefiting of their strong position which allows them to negotiate insurance terms and conditions. Besides, it is hard to specify how would a big construction company benefit from receiving standardized insurance product information

¹⁰Malinowska (2018), p. 28.

¹¹The fact that the IDD uses term of 'client' implies providing the 'enhanced protection' to all of the entities, including entrepreneurs. See: Tarasiuk and Wojno (2018), p. 130; Ziemiak and Marszelewski (2017), pp. 100–116.

document where it refers to the insurance contract conditions which were considerably modified within the course of negotiations.

4 Manufacturer

As it was already mentioned, one of the most significant change introduced by the IDD and other related acts is the possibility to consider the insurance intermediaries as product manufacturers. Namely, it is possible where an overall analysis of their activity shows that they have a decision-making role in designing and developing an insurance product for the market. Delegated Regulation provides for the definition of ‘a decision-making role’. According to this definition, the insurance intermediary has a decision-making role in particular, where he or she autonomously determines the essential features and main elements of an insurance product, including its coverage, price, costs, risk, target market and compensation and guarantee rights, which are not substantially modified by the insurance company providing coverage for the insurance product. Although, the IDD explicitly provides for the possibility to manufacture insurance product by intermediaries completely on their own, it is a fair question to ask whether a case in which insurance intermediary would act as exclusive manufacturer will occur in practice.

The author argues that it is not possible to manufacture insurance product without the insurance company’s contribution. Although, the insurance contract conditions and insurance premium tariff are initially established by broker, involvement of the insurance company is inevitable as insurance contract conditions and insurance premium tariff have to be formally adopted by the insurance company. From client’s point of view, it is the insurance company who decides whether or not to provide insurance coverage, insurance contract conditions and other issues related to compensation payment. When considering insurance product manufacturing without any contribution of insurance company, it is fair to pose a question regarding pursuing insurance activity without permission. Conducting insurance business in the territory of EU member states is reserved for strictly defined entities which meet the whole arena of requirements. It is hard to assume that the intention of the European legislator was to extend the scope of entities entitled to pursue insurance activity by the means of product governance regulation. The above arguments are supported by EIOPA’s statement ‘Technical Advice on possible delegated acts concerning the insurance Distribution Directive’¹² which states that by accepting a given risk, the insurance company covering the risk under the insurance product becomes its manufacturer.

¹²EIOPA, Technical Advice on possible delegated acts concerning the insurance Distribution Directive, <https://eiopa.europa.eu/Publications/Consultations/EIOPA%20Technical%20Advice%20on%20the%20IDD.pdf> [visited: 31.08.2019].

A situation in which broker creates so-called insurance program for an individual client and specifies in detail scope of insurance coverage will be now be considered. In such case two options can be discussed. In the first option broker adjusts (i.e. modifies, sometimes considerably) insurance contract conditions to an individual client. Here, pursuant to the Article 3 sec. 3 of Delegated Regulation, broker cannot be considered insurance product manufacturer because adaptation of existing insurance products in the context of insurance distribution activities for individual customers is not considered manufacturing. In the second option broker creates a tailor-made insurance contract under which the insurance company provides insurance coverage on the basis of specific arrangements. Similarly to the first option, broker cannot be considered manufacturer as the design of tailor-made contracts at the request of a single customer is not considered manufacturing (Article 3 sec. 3 of Delegated Regulation). Moreover, the second option raises doubts with respect to insurance product itself. As it is hard to identify any target market within the meaning of Article 3 sec. 3 of Regulation 2017/2358, it can be questioned here whether there is an insurance product at all.¹³

It goes without saying that insurance intermediary and insurance company can co-manufacture insurance products, which is confirmed by the Article 3 sec. 4 of Delegated Regulation. This kind of cooperation existed long before the IDD's implementation. So far, it was assumed that although insurance intermediary contributed to product's manufacturing, all the manufacturer's obligations were attributed to the insurance company. In turn, Delegated Regulation provides for the opposite. In according to Delegated Regulation, if both insurance intermediary and insurance company are recognized as manufacturers within the meaning of Article 2 of Delegated Regulation, they should sign a written agreement which specifies their collaboration to comply with the requirements for manufacturers, the procedures through which they should agree on the identification of the target market and their respective roles in the product approval process.

Construction of the legal provision implies that it is an obligation to conclude such agreement (*shall sign a written agreement*) once a decision-making role is attributed to both insurance intermediary and insurance company. This is, both of them determine the essential features and main elements of an insurance product.

Decision-making role of insurance intermediary can be recognized when insurance intermediary presents the insurance company insurance contract conditions which comprehensively regulate rights and obligations of contracting parties, exclusive distribution of certain product and intermediary's right to remuneration for preparing insurance contract conditions (so-called author's commission).¹⁴ Often, it is a distribution strategy applied by the insurance intermediary that allows to recognize him as a co-manufacturer. For instance, offering insurance product via an

¹³Nawracala (2019), p. 65.

¹⁴Definition of remuneration referred to in Article 2 sec. 1 point 9 of the IDD is very broad. Hence, the author's commission seems to be admissible. See: Ziemiak (2019), p. 37.

online intermediary's platform with an advertising slogan 'insurance product created by broker X in cooperation with insurer Y'.

Regardless the options stemming from the IDD, the analysis of requirements related to the product governance may lead to the following conclusion: insurance intermediaries may not be interested in acting as a product's manufacturer and concluding the abovementioned agreements because of the additional obligations it would impose on them (e.g. obligation to adopt product governance process, obligation to monitor and review product). The insurance companies had product governance processes, allocation of responsibilities and, most importantly, qualified staff long before the entry into force of the IDD. Given the fact that the intermediaries have never been formally recognized as a product manufacturer, it would be challenging for them to establish product governance process in terms of organization and costs. However, banks acting as insurance intermediaries can be considered an exception to the above assumption. It seems that the possibility of implementing product governance systems in those banks is much higher, due to the fact that they already have sufficient human, financial and organizational resources. Furthermore, noteworthy is the fact that, from the bank's perspective, possibility to act as a product manufacturer (or co-manufacturer) allows to mitigate the risks stemming from the regulation on unfair market practices and possible claims raised in relation to copyright infringements when transferring insurance programs copyrights between insurers.¹⁵

It is a fair question to ask whether the supervisory authority is entitled to impose sanctions if the abovementioned written agreement regarding joint product governance is not signed. When trying to answer this question, first the purpose of signing such agreement should be deciphered. The author claims that the agreement aims at clear allocation of responsibilities and obligations related to the product governance to avoid the situation in which certain obligation remains unallocated. It is believed that precise allocation of responsibilities ensures protection of client's interests and prevents negative competence disputes between intermediary and insurance company. However, if interests and needs of clients are protected, whilst the agreement has not been signed, there are no grounds to impose sanctions. Namely, conclusion of the agreement between intermediary and insurance company is not an end in itself. It is rather a mean or instrument for achieving the purpose of protection of the best interests of client. If the agreement on product's co-manufacturing is not concluded between intermediary and insurance company, it should be presumed that the insurance company acts as a manufacturer and all the related obligations stemming from the IDD and Delegated Regulation are imposed on the insurance company. This approach seems to be confirmed by the insurance practice, soft law (EIOPA's Technical Advice on possible delegated acts concerning the insurance Distribution Directive) and Delegated Regulation which allows insurance intermediaries to act as product's manufacturer. *A contrario*, it can be assumed that insurance companies are naturally considered manufacturers, therefore, there is no

¹⁵Mrozowska-Bartkiewicz and Wnęk (2018), p. 91.

need to stipulate this fact within the legal provisions. Following on from this argument, the insurance company will always act at least as a co-manufacturer.

Delegated Regulation does not limit types of intermediaries which may be recognized as manufacturer or co-manufacturer of insurance product. In practice, the concept of multiple intermediaries occurs both between intermediaries of one type (e.g. agents) and different types (e.g. agent and broker). This allows to reduce costs and to ensure greater distribution efficiency at various stages.¹⁶ Therefore, it should be assumed that any intermediary mentioned within the IDD is allowed to manufacture or co-manufacture insurance product. It is also possible to have insurance product co-manufactured by several intermediaries and insurance company. In such case, the agreement on joint product governance should be multilateral.

In practice, rarely insurance agents pursue activities which allow to recognize them as manufacturer due to the fact that they depend on the insurance companies. It is more common for multiagents, or even more for brokers, to act as manufacturer. However, product's co-manufacturing undertaken by broker and insurance company is an issue of different nature.

Problem of the relationship between insurance broker and insurance company has been discussed within different jurisdictions long before the entry into force of the IDD. On the one hand, it was claimed that broker acts exclusively as a representative of policyholder. On the other hand, Austrian, French and German¹⁷ jurisdictions advocated for the so-called theory of double representation which argued that there are cases in which broker represented the interests of both policyholder and insurance company.

Bearing in mind the above, interesting observations are made with respect to Polish insurance practice. Under the previously binding Polish insurance regulation, possibility of cooperation between broker and insurance company was very limited. Among all the possible agreements, legal doctrine recognized broker's commission agreements, legal clauses allowing broker to represent insurer in front of policyholder in a limited scope (e.g. receiving insurance premiums) and framework agreements regarding technicalities of cooperation between broker and insurance company.¹⁸ What is more, all agreements other than broker's commission agreements were subject to many restrictions.¹⁹ Clauses allowing broker to represent insurer were often questioned as some claimed that they indirectly allow broker to perform activities reserved for insurance agents.

Article 24 sec. 1 point 2 of Polish act of 22 May 2003 on insurance intermediation²⁰ provided for the prohibition of permanent contractual relationship between broker and insurance company. In turn, Article 30 sec. 1 point 2 of the act of

¹⁶Orlicki (2019), p. 4.

¹⁷Pokrzywniak (2005), pp. 157–173.

¹⁸Pokrzywniak (2005), p. 153.

¹⁹Malinowska (2012), p. 170.

²⁰Act of 22 May 2003 on insurance intermediation (Dz.U. 2017, poz. 2486).

15 December 2017 on insurance distribution,²¹ which implements the IDD to Polish legal system, not only repeats the abovementioned prohibition, but it also extends it by stipulating that insurance broker is not allowed to maintain any permanent contractual relationship with insurance company, reinsurance company, insurance agent or insurance agent offering ancillary insurance. Given the fact that the above regulations overlap to some extent, legal doctrine established with respect to the Article 24 of no longer binding act on insurance intermediation are still applicable to currently binding regulation. The purpose of the discussed prohibition is to prevent the situation in which broker depends on the insurance company²² and it has nothing to do with the financial value of such relationship. Rather than the remuneration which broker would receive on the basis of such relationship, it is a permanence of the relationship that is taken into consideration.²³

Not only does the agreement on joint product governance regulate technical issues regarding broker's remuneration (e.g. broker's commission), but it also implies a community of obligations imposed on broker and insurance company. The agreement should be naturally considered permanent as it regulates product governance, i.e. a process which is spread over time. Further to this, the agreement cannot be recognized as an exemption from prohibition referred to in the Article 30 sec. 6 due to which the prohibition does not apply to insurance contract where insurance broker acts as a policyholder and/or insured and to the agreement concluded between broker and insurance company regarding the method of mutual settlement for brokerage activities in the field of insurance.

The above discussed prohibition is a national instrument and the IDD does not provide for its equivalent. It is worth considering though whether there are any implications for the agreement on joint product governance. Delegated Regulation which refers to this agreement in the Article 3 sec. 4 constitutes a directly applicable legal act. This is, it is binding without implementation. Thus, the problem of incompliance between national and European regulations arises. In such case, the principles developed in the European Court of Justice could be of help. Notably, the principle of the primacy of Community law formulated in case *COSTA vs ENEL* which states that the transfer of national rights and obligations to the Community legal system entails a permanent limitation of the sovereign rights of the member states which no subsequent, unilateral act incompatible with the Community law cannot call into question.²⁴

Regardless the above, it seems that allowing to conclude the agreement on joint product governance, although it would be contrary to the Article 30 sec. 1 point 2 of the act on insurance distribution, is indispensable to achieve regulatory aim of protecting the best interests of the client. The purpose of the agreement on joint product governance is not to establish a permanent relationship between broker and

²¹ Act of 15 December 2017 on insurance distribution (Dz.U. 2003, nr 124, poz. 1154).

²² E. Wiczorek, [in:] Brodecki et al. (2010), p. 1167.

²³ Ziemia and Machulak (2018), p. 202.

²⁴ Judgment of the Court of 15 July 196, *Flaminio Costa v E.N.E.L.*, Case 6-64.

insurance company, but it is rather to ensure that all the obligations stemming from the product governance are fulfilled.

Some of the Polish scholars claim that the status of co-manufacturer can be attributed also to the insurance companies which act permanently as a co-insurer providing insurance coverage for common risks.²⁵ Although, neither the IDD nor Delegated Regulation refers to cooperation between the insurers, product's co-manufacturing by the insurers should be assumed admissible. Yet, it can be doubted whether the permanent co-insurance agreement includes product's co-manufacturing. Namely, the essence of co-insurance is its accidentalness, i.e. sharing the risk when it is impossible (e.g. due to some reinsurance restrictions) or undesirable (e.g. due to the risk exposition) for the insurance company to provide insurance coverage to the customer on its own. No co-manufacturing of insurance contract conditions (product) exists in case of these kind of co-insurance. Here, the insurance contract is concluded on the basis of the insurance contract conditions of the risk pool leader, which are subject to negotiations. Co-insurers accept insurance contract conditions offered by the leader for each individual insurance contract.

5 Identification of Target Market

Previously, identification of target market for each insurance product has been treated as a pure marketing and sale task ensuring proper communication and product's targeting, however, after the IDD's implementation, identification of target market becomes a legal obligation.

According to Delegated Regulation, identification of target market by the manufacturer should be understood as description of a group of clients who share a number of features at the general level in order to adjust product's features to the needs, features and purposes of this group. Thus, identification of target market and assessment of client's demands and needs are two different things and therefore should be distinguished.

Target market should be identified before marketing the product, i.e. at the process of product's design. Not only should the insurer firmly identify target market for a given product, but he should also verify the abstract needs, features and purposes of the group which he considers target market.

Although, Delegated Regulation provides some guidelines on how to identify target market, the instructions are rather of general nature. Delegated Regulation allows to adopt different approaches by stipulating that the level of detail of identified target market and criteria used to identify it should be '*relevant*' and enable to decide which customers belong to identified target market. With respect to simple and more common products, target market should be identified more

²⁵Kwieciński (2018), p. 167. The author did not find many similar opinions in non-Polish literature. Hence, it may be assumed the view is specific for Polish insurance market.

precisely, taking into consideration the increased risk of damage suffered by the client. Assessment of the target market should take into account the amount of information available to the target group clients and their financial education background.

Following these quite general guidelines, product's manufacturer should decide which approach to take to identify target market—whether it would be more detailed approach referring to the features and needs of given group or general approach where target market is identified at relatively high level without precisising the needs.

When considering identification of target market, it should be borne in mind that target market should be identified not only for consumers products but also for products which are offered to the entrepreneurs (*'for each product'*). It can be though challenging for the manufacturers. The insurance products which are mass offered, such as motor vehicle insurance, house insurance or life insurance, are analyzed in detail and distribution strategies are focused on identified target groups (young drivers, single-family houses owners, single persons up to 35 years old). On the other hand, in case of insurance products offered to the entrepreneurs, target groups are usually identified at high level. Clearly, the insurance company gives preference to certain businesses based on the analysis of their loss history and offers them preferential insurance premiums. However, the author claims that this kind of 'risk appetite' related to certain product or class of insurance does not correspond with target group. The primary purpose of identification of target group is to adjust features of the product to the needs, features and objectives of the group of clients, instead of the needs of insurance company. It can be depicted by the following example. Considering entrepreneur's property insurance, it is not attractive for the insurance company to provide the insurance coverage to a company producing upholstered furniture. It does not mean though the said company is excluded from the target group. Unless production of upholstered furniture is directly excluded in the insurance contract conditions, the needs and objectives of that company with respect to the protection in the event of damage to a third party arising from business operations and property possession are taken into consideration. It shows that the company producing upholstered furniture will constitute target market for entrepreneur's property insurance, although, it is not necessarily interesting for the insurance company ('risk appetite'). Lack of that interest will be reflected in the insurance premium.

Identification of target market for entrepreneurs' insurance is often underestimated. It is mostly because of the fact that entrepreneurs' insurance is exempted from the obligations resulting from product governance as they fall into the category of 'large risks'.

However, as it was mentioned in the paragraph pertaining to definitional problems, the most popular property insurance which are interesting for the entrepreneurs (8, 9, 13) are recognized as large risks only at the moment when the individual insurance contract is concluded. Therefore, the majority of entrepreneurs' insurance is subject to all the obligations stemming from product governance. Identification of target group of entrepreneurs' insurance at high level (e.g. entities conducting

business activity in Poland possessing machines up to a certain value) allows to mitigate the risk of distributing insurance product beyond target market.

Each insurance product, even the one for which target market has been precisely identified, may be distributed to the client which does not belong to its target group. Neither the IDD nor Delegated Regulation introduces prohibition of insurance distribution beyond target market. Moreover, recital 9 of Delegated Regulation specifies conditions which have to be met in order to distribute beyond target market. Individual assessment of the demands and needs of the customers should be made to verify whether the product correspond those customers. It may turn out that specific features of the client who does not belong to target market justify the conclusion that the analyzed product corresponds to his demands and needs.²⁶ Moreover, it should be borne in mind that it is possible to have insurance products which are appropriate for the clients outside target market and do not constitute a separate insurance product at the same time. For instance, if summer houses do not belong to target market of home insurance because they are excluded from the insurance coverage under the home insurance conditions, it is still possible to satisfy the demands and needs of a specific client by deleting the said exclusion from the home insurance conditions (summer house insurance).

Although, insurance distribution beyond target market in individual cases (after having analyzed insurance product and client's features and needs) does not seem to be risky, mass insurance distribution beyond target market should be a matter of serious concern to the manufacturer. According to IOPA's statement,²⁷ in such case, the manufacturer should assess the possible negative impact on the client using the product. Once such impact is identified, the manufacturer take action in order to ease the situation and prevent further occurrence of the harmful event.²⁸ When trying to ease the situation, the manufacturer can e.g. provide insurance protection to those clients on the basis of specific arrangements. In turn, preventing further occurrence of the harmful event may consists in introducing a system lock preventing intermediary from distributing outside the target market, and if the problem results from the operation of distributor, cooperation with such a distributor should be put to an end, at least in the scope of this product. Also, the discussed situation raises doubts as to the manufacturer's responsibility for distributor's actions. If distributor is chosen—according to the Preparatory Guidelines—with due caution and he was provided with all the required information on the product, its specifics, target market and planned distribution strategy, the author claims that no additional responsibility for

²⁶Noussia and Siri (2019), pp. 53–54.

²⁷EIOPA, Answers to (EU) 2017-2358 product oversight and governance requirements for insurance, <https://eiopa.europa.eu/Publications/Guidelines/Answns%20to%20Questions%20on%20%28EU%29%202017-2358%20about%20product%20oversight%20and%20governance.xlsb> [visited: 31.08.2019].

²⁸Marano (2019), p. 81.

distributor's action can be attributed to the manufacturer, particularly when the distributor enjoys the status of independent intermediary.²⁹

It is also recommended, especially with respect to the investment-based insurance products, to identify group of clients for which a given insurance product is not appropriate as it does not correspond with their needs, features and objectives. Identification of the so-called 'anti-target group' can improve quality of distribution to target market by establishing a barrier for access to the product for the clients defined as anti-target group.³⁰ For instance, considering life insurance, insurance contract conditions may exclude persons aged 60 and more from the possibility of being provided with the insurance coverage. Simultaneously, a relevant automatic blockade could be implemented to the sale IT system in order to prevent further proceeding once the intermediary inserts birth date on the basis of which IT system recognizes client's age as 60 or more.

Obligation to identify target market and other obligations stemming from product governance (particularly obligation to prepare insurance product information document) are questioned with respect to mandatory insurance. In some jurisdictions, e.g. in Poland, the law requires certain objects to be insured as well as it precisely specifies scope of the insurance, its conditions, the guarantee sum and lists of exclusions. Insurance premium tariffs is the only element which can be designed here by the insurance company. However, neither the IDD nor the national regulation (Polish) provides for any legal grounds for the possibility to exclude the insurance company from the obligations stemming from product governance. Although, identification of target market should not be difficult (the author proposes to assume that target market consists of the persons who are obliged to insure), preparation of standardized insurance product information document may be challenging. Namely, the law regulating mandatory insurance does not specifies all the issues which are required by the IPID regulation.³¹ Thus, there is a risk that some issues would be incompliant with intention of the legislator.

6 Impact of the IDD on Insurance Market's Participants

The IDD constitutes the first legal act which addresses product governance issues. So far, product governance was mentioned in some soft law acts (European and national recommendations), however, it was mostly left to the insurance companies.

²⁹Financial Conduct Authority, *Insurance Distribution Directive implementation – Feedback to CP17/23 and near-final rules*, <https://www.fca.org.uk/publication/policy/ps17-27.pdf>, p. 24 [visited: 31.08.2019].

³⁰M. Roguski, [in:] Ziemia and Machulak (2018), p. 111.

³¹Commission Implementing Regulation (EU) 2017/1469 of 11 August 2017 laying down a standardized presentation format for the insurance product information document (Official Journal of the European Union L 209/19).

In consequence, product policies of insurance companies were very different. Some of them consisted of an extensive process of launching a new product, including scenarios related to profitability and customers impact, while others focused on determining the potential profit from launching a specific product.

Establishing certain rules at the statutory level, e.g. obligations stemming from product governance, identification of target market, preparation of product's documentation facilitating comparison between the products or assessment of the client's demands and needs, allows national supervision authorities to carry out inspections and impose relevant sanctions. The level of requirements for product manufacturers and distributors initiated by the IDD is very high. Drawing on the findings of the analysis made by Deloitte in the member states of resilient and developed insurance markets, it results that similar requirements exist only in Germany and Great Britain. Many other countries provide for less strict regulations, while in some jurisdictions there were no regulation of product governance (Spain and France).³²

Adjustment of the insurance business to the new product governance requirements is considered very expensive due to the following reasons: the need to create product documentation for each product (identification of target market, standardized insurance product information document, anti-target group), changes to the internal processes (product approval process), implementation of permanent product's supervision (product monitoring), selection and controlling of distribution strategy. Moreover, the IDD extends the scope of the entities responsible for product governance by adding insurance intermediaries. As it was mentioned in the paragraph addressing product manufacturer issue, it may be impossible for the intermediaries to meet the above requirements due to the costs, lack of organizational resources and lack of experience. It may further result in intermediaries resigning from being product manufacturer (at least formally) and giving way to insurance companies.

Regardless the industry's criticism, the European legislator did not differentiate obligations stemming from product governance. Clearly, the measures provided for in the IDD aim at harmonizing and improving the level of customer protection to eventually achieve the highest standard of protection regardless of the distribution channel. Undoubtedly, what stands behind these goals is also the desire to rebuild customer confidence in insurance markets.³³

Nevertheless, a broad approach to the obligations which does not take into consideration the individual risk-taking seems to be contrary to the IDD's objectives.³⁴ Although the preamble to the IDD mentions principle of proportionality and rationality with respect to the interpretation of the legal provisions, the majority of

³²Deloitte, *Insurance Distribution Directive. 2018: a challenging year for the European insurance sector*, <https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/Insurance/lu-insurance-distribution-directive-2018-challenging-year-european-insurance-sector-012018.pdf>, p. 24 [visited: 31.08.2019].

³³Więcko-Tułowicka (2018), p. 78.

³⁴Malinowska (2017), p. 15.

member states decided to ‘copy-paste’ the IDD’s provisions to their national legal systems.

In consequence, it can be assumed that the insurance intermediaries will not be pursuing activities which may put them in a position of product manufacturer in order to avoid adjusting their business to the whole set of requirements introduced by the IDD and Delegated Regulation. In turn, the insurance companies will probably focus on main and standard products and will be reluctant to distribute insurance products covering new risks. Each time, creation of new product would mean extreme work consumption at the beginning, regardless of the final results.

7 Conclusions

Upgrading product governance to the statutory level constitutes part of the global trend which emerged as a result of the loss of trust in financial markets after the crisis of 2008.³⁵ The activity of national legislators is driven by the doubts that arose over markets’ resiliency and their ability to meet public interest objectives.³⁶ However, it should be underlined that excessive regulation can easily result in overregulation. This, in turn, may jeopardize development of markets, market participants activity and natural self-regulation. It can also lead to ‘automation’ in execution of obligation towards clients (provision of documents, signing forms) which would leave no room for a real assessment of client’s needs.

The IDD and implementing acts (particularly Delegated Regulation) are of great importance for the product governance as they changed it into a legal obligation of insurance distributors. It is also necessary to underline the role of transparency (i.e. transparency of products, processes and entities) as a guaranty of protection of client’s best interests.³⁷ So far, processes related to the product’s life cycle were subject to the internal arrangements of the insurance company which could result in unequal protection standards offered to the customers.

Nonetheless, the discussed regulation creates a number of problems which have been addresses in this chapter. The European legislator does not seem to pay enough attention to the use of terminology created for the IDD’s purposes (client, product, product governance) which makes it difficult to identify objective and subjective scope of the imposed obligations. Furthermore, the author draws the attention to the fact that the differences between the distributors³⁸ (insurance company vs broker) and types of products (house insurance for customers vs specific property insurance for entrepreneurs) have not been taken into account which resulted in the same regulation governing different situations.

³⁵See also: Marano (2017), pp. 5–29.

³⁶Monkiewicz (2014), p. 86.

³⁷Malinowska (2016), p. 90.

³⁸Maesschalck (2017), pp. 59–77.

When assessing satisfaction of the IDD implementation, the *ratio* of regulation, i.e. client's best interest, should be borne in mind. Undoubtedly, restrictive requirements related to the product governance are likely to enhance protection of client's best interest. An attention should be now drawn to their proportional application in different situations, taking into account type of the product and distributor. Notably, it is worth to give a second thought to the concept of the distributor acting as a manufacturer and co-manufacturer of the product, especially with respect to the obligations that this role entails. Finally, it is necessary to modify—formally or through soft law instruments—a subjective exemption. This is, the status of 'large risk' which exempts from the product governance obligations should be replaced with a different criterium.

As it was mentioned in the introduction to this chapter, it is still too early to assess the efficiency of the IDD or to formulate any firm conclusions. Nevertheless, it is clear that there are fields in which the IDD's provisions should be implemented wisely and not literally, while the proper interpretation of the implementation should be left to the academia.

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