Professional Insurance Brokers Association Submission to The Business Regulation Forum

Introduction

The development of the regulation of *insurance brokers* in Ireland could be used by the Business Regulation Forum as an exhibit of how:

- the absence of clearly defined cost/benefit or regulatory impact analysis of proposed regulatory developments leads to over-regulation, and how
- regulation can consequently grow, accumulate and feed on itself without any check, ultimately to the detriment of those for whom the regulation was put in place in the first place to protect.

Insurance Brokers

Insurance brokers:

- generally act as the agent of the client in arranging insurance cover, savings, investment and pension policies with insurers.
- Do not handle client monies or premiums, except in certain specified limited circumstances where the relevant insurer is responsible for the monies.

They therefore represent a 'low risk' category of financial services provider, in terms of risk to the financial system generally or to individual consumers.

The regulation of insurance brokers, pre 2001

The Insurance Act 1989 (Part IV) introduced a simple, uniform and cost effective system of regulation of all insurance intermediaries which applied right up to April 2001:

This regulatory system worked well, at a low direct cost to the industry, the Exchequer and consequently consumers. Its main features were:

- *status identification to the consumer* : either insurance broker (> 4 agencies), insurance agent (<5 agencies), and tied insurance agents.
- requirement to hold a *written agency appointment* with an insurance undertaking in order to place business with that insurer.
- insurers maintain a *register of appointed insurance intermediaries*
- clarification of the circumstances in which the *intermediary acts as the agent of the insurer*, as opposed to the agent of the client
- protection of client monies, through dedicated *client money accounts*, associated *bonding*, and *identification of responsibility of insurers for premiums*

Further consumer protective measures were subsequently introduced separately by :

- 3rd Life Directive Framework regulations which provide for a statutory cooling off period of 30 days, for most types of policyholders, with effect from 1995 onwards
- Investor Compensation Act, 1998. Clients of insurance brokers are covered by this compensation system since 1998. However to date there has only been one €20,000 claim from the scheme related to one insurance broker; by comparison claims on the scheme arising from the collapse of two different Stockbrokers currently amounts to almost €9m.
- Life Disclosure Regulations, 2001 provide for statutory disclosure of projected charges and intermediary remuneration to the client at the point of sale, in relation to most life assurance policies effected on or after 1st February 2001.

April 2001 system of regulation

It was decided by Government to move the regulation of insurance intermediaries to the then Central Bank of Ireland with effect from April 2001.

While the Central Bank could have taken over the existing system of the regulation of insurance intermediaries (which had worked well since 1989 up to then), instead they opted to use a regulatory system used for the regulation of investment firms, i.e. the Investment Intermediaries Act, 1995.

The use of this system to regulate insurance intermediaries was :

- completely unnecessary; the Investment Intermediaries Act system implemented into Irish law the Investment Services Directive system which has not and still does not apply to the activities of insurance intermediaries. It amounted to using a system of regulation designed for a completely different purpose (i.e. the regulation of a wide variety of cash handling investment firms) to regulate insurance intermediaries, at a time when a perfectly adequate system of regulation for insurance intermediaries already existed. It was a local Irish decision to make insurance intermediaries subject to the Investment Intermediaries Act regulatory system; it was not an EU requirement.
- implemented without any cost benefit or regulatory impact analysis; the question was never posed ... would the consumer be better off than before with the new system of regulation of insurance intermediaries? Would the extra costs of regulation, which eventually falls on the consumer, be worth it in terms of enhanced protection for the consumer?

Over-regulation

Using the Investment Services Directive regulatory system to regulate insurance intermediaries (something that it was never designed for) has lead to unnecessary levels of regulation of insurance brokers and also has given rise to certain market anomalies:

- new categorisations of insurance intermediaries (*Multi Agency Intermediaries* and *Authorised Advisers*) were confusingly placed on top of the existing nomenclature of *insurance broker, insurance agents* and *tied insurance agents* leading to a confusing mix of titles for consumers.
- a requirement for all insurance intermediaries, even sole traders, to be audited regardless of turnover, and submit audited accounts annually to the Financial Regulator
- Authorised Adviser must submit half yearly unaudited accounts to the Financial Regulator
- a capital adequacy requirement of €10,000 for Authorised Advisors

- Sole trader insurance brokers required to provide a Certificate of Solvency to the Financial Regulator annually
- public notice publication of all termination of agency appointments with insurers
- requirement to notify and seek the Financial Regulator approval re any change in '*qualifying holdings*' in the firm, i.e. a shareholding of 10% upwards.
- new intermediaries have to seek authorisation from the prudential regulation part of the Financial Regulator, a process more suited and relevant to financial institutions and cash handling investment firms.
- insurance intermediaries subject to the Financial Regulator requirements re Compliance Statements.
- conduct of business rules which are generally not modulated , to any significant extend, according to the nature of the product being recommended to the client, e.g. similar fact finding and reason why requirements apply to insurance intermediaries (excluding credit institutions) selling mortgage protection cover to a client as they would if selling a hedge fund of hedge funds.

Over regulation of the sales/advisory process can be clearly seen in the sale of Personal Retirement Savings Accounts (PRSAs) which were launched in early 2003 and have generally failed to achieve any mass market penetration.

For example, one of the reasons for the poor take-up of PRSAs, mentioned in newspapers reports of the likely content of the Pensions Review, was over-regulation of the PRSA sales/advisory process.

Take, for example, an insurance broker advising an employee about contributing to a PRSA. The employee will end up with and/or have to sign the following pieces of paper :

- Intermediary's *Statement of Authorised Status*.
- Intermediary's *Fact Find.* Client may have to sign this.
- Intermediary's *Terms of Business letter*. Client may have to sign this.
- *Non Standard PRSA Declaration*, if non Standard PRSA being recommended to the client. The client would be required to sign this.
- *Preliminary Disclosure Certificate*
- Intermediary's *Reason Why statement*. Client will usually have to sign this
- Intermediary's *Section 30 receipt*. (where payment is by cheque)
- *PRSA application form*. Client will have to sign this.

- *PRSA contract*
- Initial *Statement of Reasonable Projection*.

Clearly this is regulation gone mad. A simple process of an employee taking out a personal pension plan has been turned into a forest of regulatory compliance paperwork.

The Irish Times of the 17th November 2005 in relation to the Pensions Review Report said :

'*The Report looked at ways in which regulatory and other obstacles to people taking out PRSAs can be reduced. They want to eliminate the requirement for the broker or company selling the PRSA to carry out a detailed examination of the purchaser's finances first.'*

In this the consumer has been the real loser; many intermediaries and other advisers have avoided selling PRSAs due to the high level of regulation bureaucracy involved.

This is just one example of the negative practical impact of over –regulation of insurance intermediaries.

Market anomalies

The new Investment Services Directive system of regulation (i.e. the Investment Intermediaries Act, 1995) of insurance intermediaries also has led to various anomalies in the regulation of different forms of insurance intermediaries :

- accountants acting as insurance intermediaries on an '*incidental basis'* are self regulated by their own professional body, an option not open to full time insurance intermediaries
- Stockbrokers acting as insurance intermediaries are not regulated at all in relation to their insurance intermediary activities
- credit institutions acting as insurance intermediaries are not regulated as insurance intermediaries like full time insurance brokers; rather their insurance intermediary activities are regulated as an adjunct to the regulation of their banking services.
- insurance conduct of business rules which differ between credit institutions acting as insurance intermediaries and full time insurance brokers. For example:
    - credit institutions are not required to provide '*reason why'* statements to clients, whereas other insurance intermediaries are
    - credit institutions are not required to conduct *fact finding* in relation to mortgage protection, whereas other insurance intermediaries are.

- o credit institutions are allowed to make unsolicited contact with existing clients for whom it has provided a 'banking service' within the last 12 months, whereas other insurance intermediaries can generally only make unsolicited contact with existing clients where they have provided an 'investment business service' within the last 12 months.

Better Regulation – January 2004

The Irish Government published a White Paper on 'Better Regulation' in January 2004.

Some quotations from the Taoiseach's speech launching this document include:

"… we can't keep adding new regulations and expect that there will be no downsides!

….

Of course, people are aware of the cost burdens which regulation imposes. We all know that by increasing the volume and complexity of regulation we increase the burden of compliance on business and that these costs fall disproportionately on small business. What is often lost sight of by policy makers is the growing burden of cost for the Exchequer in terms of regulatory bodies, inspectorates and prosecutions.

...

We have set down six principles: necessity, effectiveness, proportionality, transparency, accountability and consistency. Together, these principles will help to inform our decisions about regulation going forward."

We fully subscribe to the six principles of better regulation outlined above, and feel that the current system of regulation of insurance intermediaries does not comply with these principles.

The Insurance Mediation Directive

The Insurance Mediation Directive (2002/92) provides an EU wide system for the regulation of insurance intermediaries, and was brought into force in Irish law on 15th January 2005, by way of a Statutory Instrument.

The IMD Regulations set out a number of requirements for all insurance intermediaries, including:

- identification of nature of advice being offered to the consumer, i.e. based on a fair analysis, not based on a fair analysis and tied or multi tied.
- a requirement to have a specified minimum level of PI cover

- the possession of appropriate knowledge and ability. The Financial Regulator is likely to prescribe minimum competency standards in this regard, in 2006.
- modulation of the reason why requirement, according to the complexity of the insurance product being recommended.

The IMD system provides a sensible, proportionate and uniform system of regulation of insurance intermediaries and obviates the need to continue regulating insurance intermediaries under the Investment Intermediaries Act, 1995, which was designed for a totally different purpose, i.e., the implementation of the Investment Services Directive.

Most all other countries in Europe are only regulating insurance intermediaries by the provisions of the Insurance Mediation Directive.

Three layers of regulation ... confusion and conflict

As it now stands, insurance intermediaries are regulated by a mix of **three** different and , in some circumstances, conflicting regulatory systems:

- **remnants of the original Insurance Act 1989 system**
- the **Investment Intermediaries Act, 1995 system**, which as already pointed out was designed primarily to regulate cash handling investment firms, and not non cash handling insurance intermediaries
- the **Insurance Mediation Directive Regulations**, which implement an EU wide common system of regulation of insurance intermediaries.

Confusion and conflicting requirements apply.

For example, the Investment Intermediaries Act regulatory system tags *of 'Multi Agency Intermediary'* and '*Authorised Adviser'* sit uncomfortably with the IMD possibilities of an insurance intermediary, in <u>any individual case</u>, choosing to offer advice based on an independent or multi tied basis.

The two regulatory systems conflict. The Financial Regulator has not clarified how an average insurance broker can reconcile, in his or her day to day activities, these two apparently conflicting regulatory systems

Proposal

We feel that subjecting insurance intermediaries in relation to the **SAME** insurance intermediary activities to two separate and conflicting regulatory systems is completely unnecessary and against the Government declared principles of Better Regulation, i.e. against the principles of:

- necessity
- proportionality
- consistency.

Our proposal is that **insurance intermediaries in relation to their insurance intermediary activities should only be regulated under the IMD Regulations**.

Combined with:

- full disclosure of charges and commissions under the existing Life Assurance Disclosure Regulations,
- a statutory right to a 30 day cooling off period,
- coverage by the Investor Compensation Act system,
- compulsory PI cover of €1.5m under the IMD Regulations
- common competence requirements to be specified by the Financial Regulator in 2006,

we feel such a system of regulation offers real and substantive protection for consumers, through a simpler, less bureaucratic and less costly regulatory system.