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Briefing Note for BIPAR National Member Associations

IDD Delegated Regulations

Product Oversight and Governance Requirements

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Editorial

The Directive (EU) 2016/97 of 20 January 2016 on insurance distribution (**IDD**) authorises the European Commission to adopt certain delegated regulations to define more precisely various regulatory requirements of the IDD. Such authorisations apply – generally with respect to all insurance products concerned except for those concerning large risks – to the topic product oversight and governance requirements (Art. 25 IDD) and – solely with respect to insurance-based investment products – to the topics management of conflicts of interest (Art. 27 and Art. 28 IDD), inducements (Art. 29 IDD) and assessment of suitability and appropriateness and reporting to customers (Art. 30 IDD).

The EU Parliament and the Council expressed no objections, and the delegated regulations were published in the Official Journal of the European Union on 20 December 2017 (L 341/1, L 341/8).

The IDD and the delegated regulations were originally intended to apply from 23 February 2018, but on 20 December 2017 the European Commission proposed pushing back the application date of the IDD by seven months to 1 October 2018.

As a reason for its proposal, the European Commission cited the need to allow more time for insurance companies and insurance distributors to better prepare for the proper and effective implementation of the Directive and to implement the technical and organisational changes necessary to comply with the delegated regulations.

This proposal was adopted by the European Parliament and the Council on 14 March 2018, with retroactive effect as of the initial application date of the IDD and published on 19 March 2018 (L 76/28). Member States are now required to adopt and publish the necessary laws, regulations and administrative provisions implementing the IDD by 1 July 2018 and to apply them by 1 October 2018 at the latest.

In order to align the application of the delegated regulations to the new application date of the IDD, a separate act was published on 6 April 2018 (L 90/59). According to this act, the delegated regulations concerning product oversight and governance (**POG**) and insurance-based investment products (**IBIPs**) will apply directly to the area of insurance distribution and therefore to insurance intermediaries (**intermediaries**) as of 1 October 2018 without any need for national implementing laws.

Based on the delegated regulations concerning POG, CMS has produced this briefing note for and in cooperation with BIPAR. The note is addressed to the member associations of BIPAR and is intended to provide an overview and orientation on how the business organisation of intermediaries might need to be adapted with regard to the new rules.

This briefing note deals with the general POG regulation requirements applying for insurance undertakings (**insurers**) and intermediaries. It is based on the POG regulation as submitted by the European Commission which still requires formal validation by the European Parliament and the Council of the EU. Please note, therefore, that the regulation text may be subject to change, although we do not expect it to change substantially. Please note further that the briefing note is not exhaustive and is provided solely for general information purposes. It should not be relied upon as legal advice. Professional legal advice should always be obtained before applying the information to particular circumstances.



Introduction

Background

IDD directive, national implementing laws and EU regulations

The IDD is based on the so-called Lamfalussy Process. At Level I of this process, the EU Parliament and the Council of the EU have adopted the IDD as a framework directive updating the Insurance Mediation Directive (IMD) dating from the year 2002. The Member States are requested to implement the new rules of the IDD by 1 July 2018 and to apply them by 1 October 2018 at the latest. In this regard, the IDD does not apply directly. Actually, the national implementing laws are decisive. With regard to the national implementations, however, it should be noted that the aim of the IDD is to achieve a minimum harmonisation. This means that its rules set a standard that national legislation must meet. However, national law may exceed the terms of the IDD in order to protect customers, provided that such provisions are consistent with Union law, including the IDD. The IDD thus defines a minimum standard and generally does not prevent the national lawmakers from maintaining or introducing more stringent rules for their countries (see Recital 3 of the IDD).

In contrast to this, on Level II the EU regulations with regard to the IDD – and thus the POG Regulation as subject matter of this briefing note – will apply directly without any need for national implementing laws.

In addition to Level I and Level II, on Level III there will be guidelines and recommendations to be issued by EIOPA whereas on Level IV the Commission will supervise the implementation by the Member States.

National implementing laws are of particular relevance |

The Lamfalussy Process leads to a complex and generally somewhat confusing situation where rules on the national level and rules on the EU level complete each other and apply simultaneously. Moreover, due to the concept of minimum harmonisation, differences between the IDD rules and the respective national implementing laws are likely to exist. Therefore, besides the directly applicable regulations on Level II, intermediaries must

in any case take a close look, in particular, at the national implementing laws of their respective home country concerning the IDD rules on Level I. In the event of activities in other countries, the implementing laws of the country of activity should further be checked with regard to deviating provisions to be observed, as the case may be.

Delegated Regulation on product oversight and governance

According to the European legislator, product oversight and governance (POG) (Art. 25 IDD) plays a key role in customer protection.

POG, in particular, serves to ensure that insurance products meet the needs of a target customer market, and thereby prevents mis-selling. The Delegated Regulation (EU) supplementing Directive (EU) 2016/97 of the European Parliament and of the Council of the EU with regard to product oversight and governance for insurance undertakings and insurance distributors (**POG Regulation**) as submitted by the EU Commission to the Parliament and the Council of the EU introduces generalised POG requirements into EU insurance distribution law, applicable to the whole lifetime of insurance products. The introduced requirements serve to ensure that all insurance products marketed are appropriate for their specific target market at all times.

The rules of the POG Regulation (**POG rules**) initially address **manufacturers** developing insurance products. According to the POG rules, manufacturers must, in particular, maintain, operate and review a product approval process, which must be set out in a written POG policy.

Moreover, the POG rules concern **distributors** that advise on or propose insurance products manufactured by others. According to the POG, the distributors must, in particular, put in place product distribution arrangements to ensure that they possess the information they need to sell the product in line with the POG policy set by the manufacturers.



Whereas insurers generally are the manufacturers of the products they market, intermediaries are distributors if they have no influence on the essential features and main elements of an insurance product and only sell the product (see Who is manufacturer and who is distributor? below). In this case, intermediaries need to ensure compliance only with the POG rules applying to distributors. However, the POG Regulation specifies in detail under which (special) conditions intermediaries manufacture insurance products and as manufacturers therefore need to observe the POG rules applying to such.

Scope of Application

As of what date do POG rules apply?

The POG Regulation will apply as of 1 October 2018. The POG rules will then be relevant for all newly developed insurance products and for significant adaptations of existing insurance products before these products are marketed (Art. 1 POG Regulation).

Significant adaptations | The POG Regulation does not contain a definition or guidance as to when a product will be deemed to be significantly adapted. There is, however, good reason to believe that only important changes to the main elements of an existing product such as coverage, premium, costs, risks, target market or benefits of a type of contract constitute a relevant adaptation.

Retrospective application? | The POG Regulation contains no provisions concerning products already manufactured or marketed and sold before the time of its application. Therefore, there is good reason to believe that the POG rules generally apply to such products only under the aspect of significant adaptations. Accordingly, with regard to insurance products that were brought to the market before 1 October 2018 and that have remained unchanged, generally no POG rules of the IDD and the delegated regulation would need to be observed. Intermediaries should, however, check whether the national laws contain deviating provisions or whether national regulators and courts will take a different opinion.

However, the POG rules generally apply to all sorts of insurance products and not only to IBIPs or complex insurance products. For example, also non-life products with a limited, easily understandable scope intended for the mass retail market are subject to POG. Therefore, only insurance

products that consist of the insurance of large risks are not included in the scope of application of the POG rules (Art. 25 (4) IDD).

Who is addressed and who is not addressed by POG rules?

As already indicated above, the POG rules apply to insurance undertakings and insurance intermediaries (Art. 25 (1) IDD, Art. 2 POG Regulation).

However, not addressed by the POG rules are reinsurance undertakings and reinsurance intermediaries (see Art. 2 (1) (5) (7) IDD).

No relevance for reinsurance distribution | The POG rules thus do not apply to the whole area of reinsurance distribution at all. With regard to reinsurance products, intermediaries are not requested by the IDD and the POG Regulation to conduct any POG.

Like reinsurance undertakings and reinsurance intermediaries, ancillary intermediaries are not affected by the POG rules which apply to manufacturers (Art. 25 (1) (1) IDD, Art. 2 (1) (4) IDD). However, in contrast to this the POG rules for distributors are relevant to ancillary intermediaries as well and need to be observed by them (Art. 25 (1) (6) IDD, Art 2 (1) (4) (8) IDD).

Partial relevance for ancillary intermediaries | According to this, ancillary intermediaries generally do not have the status of manufacturer and do not need to observe the POG rules which apply to such. This means, in particular, that they do not need to maintain, operate and review a product approval process (with regard to the POG for rules for manufacturers not applicable to ancillary intermediaries see below). However, by contrast, ancillary intermediaries do have the status of distributors and need to observe the POG rules applying to such. This means that ancillary intermediaries also need to put in place product distribution arrangements to ensure that they have the information they need to sell the product in line with the POG policy set by the manufacturers (with regard to the POG rules for distributors applicable to ancillary intermediaries see below).



To which insurance products do POG rules apply?

Exemption of insurance products concerning large risks | The formal definition of large risks to which the IDD refers is found in Art. 13 (27) of the Solvency II Directive 2009/138/EC.

According to this, insurance products concerning the following risks constitute large risk and are as such not subject to the POG rules:

- (i) railway rolling stock (damage to property), (ii) aircraft (damage to property and liability) (iii) ships (sea, lake, river and canal vessels) (damage to property and liability) (iv) goods in transit (including merchandise, baggage, and all other goods).
- (i) credit or (ii) surety where the policyholder is engaged professionally in an industrial or commercial activity or in one of the liberal professions, and the risks related to such activity.
- (i) fire and natural forces, (ii) land vehicles (iii) other damage to property, (iv) general liability, (v) motor vehicle liability and (vi) miscellaneous financial loss in so far as the policyholder exceeds the limits of at least two of the following three criteria:
 - balance-sheet total: 6.2 million Euros,
 - net turnover: 12.8 million Euros,
 - average number of employees during the financial year: 250.

If the policyholder belongs to a group of undertakings for which consolidated accounts are drawn up, the criteria mentioned above are applied to the consolidated accounts.

According to this, in addition to the area of reinsurance products (see above), as well large risk insurance products are exempted from POG requirements. However, apart from these areas, the POG rules need to be observed.

To what extent is the principle of proportionality relevant for the POG rules?

The IDD already sets out that its rules should not be too burdensome for small and medium-sized insurance distributors and that one of the means by which to achieve

this objective is the proper application of the principle of proportionality (see Recital 72 of the IDD).

Principle of proportionality | The IDD refers with regard to the principle of proportionality to Article 5 of the Treaty on the European Union setting out that the content and form of EU actions may not exceed what is necessary to achieve the objectives of the EU treaties. In line with this – as is the case with regard to other EU directives – the principle of proportionality is not only relevant with regard to the degree of the legal provisions imposed by the EU and the respective national lawmakers on intermediaries and insurers and with regard to the IDD, but also to the question what degree of the requested IDD measures can be demanded in the particular case from intermediaries and insurers, considering the specific distribution activity conducted.

Proportionality in the context of the POG Regulation means that in relation to the requested POG measures and procedures (i.e., in particular, the product approval process, the manufacturers’ POG policy and the distributors’ product distribution arrangements) manufacturers or distributors need to consider and choose the measures depending on:

- the complexity of the product and the degree to which publicly available information can be obtained,
- the nature of the insurance product and the risk of consumer detriment related to it,
- the characteristics of the target market,

the nature, scale and complexity of the relevant business of the manufacturer or distributor (see Recital 2 IDD).

Principle of proportionality and POG rules | It can be concluded that proportionality affects whether and how particular POG requirements can be met by intermediaries and which efforts they have to undertake in this regard. Due to the fact that the POG rules of the POG Regulation are not limited just to “complex” insurance products, the principle of proportionality is thus of particular importance. As a basic rule, POG measures (see Recital 2 POG Regulation):

- can be relatively simple for straightforward and non-“complex” products that are compatible with the needs and characteristics of the mass retail market



– need to be more exacting for “complex” products with a higher risk of consumer detriment

Beyond this general approach, the POG Regulation contains express references to the principle of proportionality in several of its provisions, which should be considered by intermediaries in connection with the relevant requirements (see, e.g., Art. 4 (1), Art. 6 (1), Art. 7 (2), Art. 10 (4) POG Regulation) (for further details please see below).

Documentation

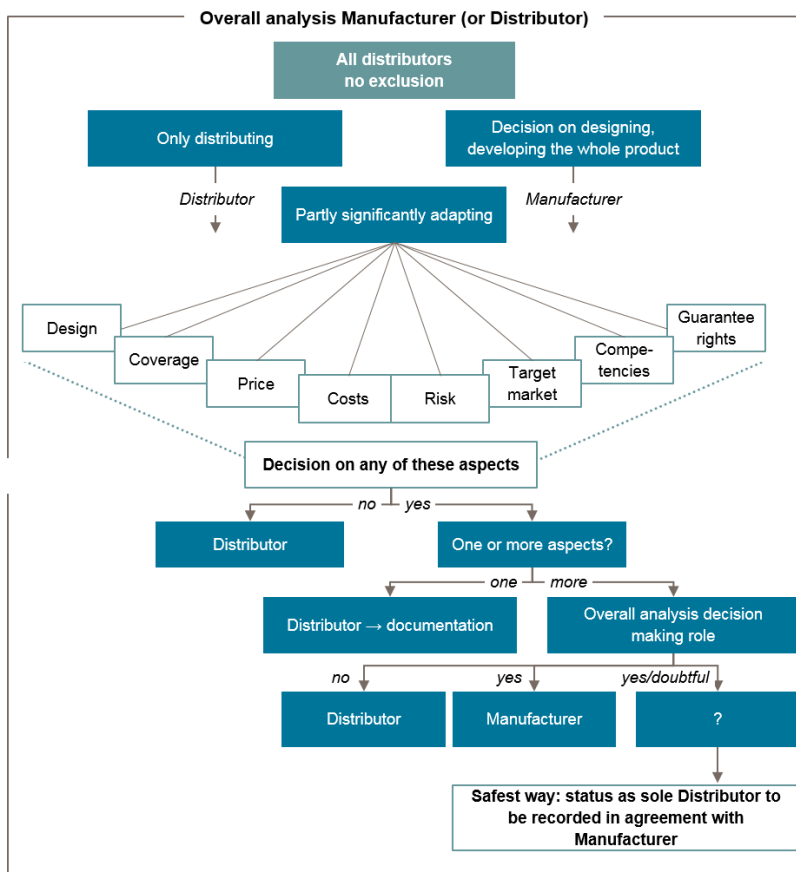
A further central as well as general aspect of the POG rules applying to manufacturers and distributors is the requirement of documentation. Manufacturers are thus required to document the relevant actions taken in relation to their product approval process. The documentation must be kept for audit purposes and made available to the competent authorities upon request (Art. 9 POG Regulation). The same applies to distributors with regard to their product distribution arrangements (Art. 12 POG Regulation) (for further details please see below).



Who is manufacturer and who is distributor?

Relevance of the question

The question as to whether an insurer or an intermediary is a manufacturer or distributor of an insurance product is relevant to determine whether the insurer or intermediary will need to comply with the POG rules for manufacturers or with the POG rules for distributors.



Please note: Personalisation of and adaptation of existing insurance products in the context of insurance distribution activities for individual customers, as well as the design of tailor-made contracts at the request of a single customer, are not considered manufacturing (Art. 3 (3) POG Regulation).



Manufacturing distributors | The wording and structure of the POG Regulation suggests that a manufacturer needs to comply only with the POG rules for manufacturers and that a distributor needs to comply only with the POG rules for distributors.

In any case, this indication is valid with regard to **distributors** who advise on or propose insurance products that they do not manufacture, and with regard to **manufacturers** who do not directly sell the product they manufacture. It is, however, not entirely clear whether intermediaries who are manufacturers of an insurance product that they also distribute directly (**manufacturing distributors**) need to comply with the manufacturer POG rules only, or whether such intermediaries additionally need to observe the distributor POG rules.

Neither the IDD nor the the POG Regulation contain any clear indication or guidance in this regard. However, it seems to be reasonable to assume that at least when an insurer or an intermediary possesses different business units and one of the business units manufactures a product which is then distributed by another business unit, both the POG rules for manufacturers as well as the POG rules for distributors apply. In fact, the regime for manufacturers should be observed by the manufacturing business unit and the regime for distributors should be observed by the distributing business unit (see definition of distributor in the comparable guidelines on POG requirements for retail banking products from the European Banking Authority (EBA)).

Circumstances under which intermediaries are manufacturers

The IDD already defines insurers as well as intermediaries as manufacturers if they develop insurance products for sale to customers (Art. 25 (1) IDD).

With regard to insurers, this brief definition set out in the IDD is already sufficient to show that, in general, insurers have to be regarded as the manufacturers of their products. With regard to intermediaries, however, further clarification is necessary. With regard to them, the POG Regulation specifies in detail under which special conditions intermediaries possess the status as manufacturers.

According to these specifications, intermediaries are manufacturers of insurance products (only) where an **overall analysis** of their activity shows that they have a

decision-making role in designing and developing the product for the market (Art. 3 (1) the POG Regulation).

Overall analysis | Even though this is not stated expressly, the request to conduct an overall analysis is apparently a requirement which intermediaries need to observe with regard to their business organisation. According to this, it seems to be reasonable for every intermediary not only selling an insurance product but having some influence on the essential features and main elements of such product to consider conducting and documenting the outcome of such an overall analysis on a case-by-case basis for products newly developed or significantly adapted after the POG rules come into force.

If it becomes clear within the context of such an analysis that an intermediary indeed autonomously decides on several essential features and main elements of an insurance product, the intermediary might be a manufacturer.

The features and elements of an insurance product relevant with regard to the decision-making role of a manufacturer are:

- design,
- coverage,
- price,
- costs,
- risk,
- target market,
- competencies,
- guarantee rights.

However, activities of intermediaries related to the mere adaptation of existing insurance products should not be regarded as manufacturing a product. In this case, the decisions on the essential features and main elements of the product are made by the insurer and not by the intermediary. The insurer is thus the manufacturer of the product and not the intermediary.

Furthermore, there is good reason to believe that even in the event the analysis shows that an intermediary can decide on only one of the denoted relevant features and elements, a sufficient decision-making role and, therefore, the intermediary's status as manufacturer is not shown to exist. In this case, intermediaries are distributors and do not need to observe the POG rules for manufacturers. Also for such intermediaries, only the POG rules for distributors should be relevant.



Case studies

Intermediaries should consider more closely that they are manufacturers if (see Art. 3 (2) Regulation POG):

- they design a new product or adapt an existing product significantly and thus take the initiative to plan and define the essential features and main elements of it;
- they sell a new or significantly adapted product under their brand name and/or own the intellectual property rights in the brand name of the product.

Examples:

- An underwriting agency who defines a certain kind of coverage that does not already exist in the market and then sells it on behalf of insurers.
- An insurance broker who develops a new insurance broker wording and then places it under its brand name on behalf of policyholders with insurers.

Intermediaries are not manufacturers if (see Art. 3 (3) POG Regulation):

- they only personalise and simply adapt an existing insurance product;
- they develop and design an insurance product in terms of a tailor-made contract at the request of a single customer.

Examples:

- An intermediary who works with more than one insurer, choosing with regard to the sales process between different lines of insurance products, contractual clauses and options, or recommending assets which are offered by the insurers with whom the intermediary works together.
- An insurance broker who analyses the individual demands and needs of a particular customer and based on this develops and places a tailor-made insurance contract for the customer with an insurer.

Insurers and intermediaries as (co-)manufacturers of a product

In the event an insurer as well as an intermediary play a decision-making part in designing and developing a single insurance product for the market, both of them can be the manufacturers or rather the **co-manufacturers** of this product.

Overall analysis with regard to the status as co-manufacturer | Even where an insurer is the manufacturer with regard to an insurance product, this does not necessarily mean that an intermediary cannot, at the same time, also be a manufacturer of this product. When the POG rules come into force, the described overall analysis thus needs to be conducted by intermediaries also if an insurer is already the manufacturer of an insurance product newly developed or significantly adapted and if in addition to the insurer the intermediary decides on essential features and main elements.

In the event an insurer and an intermediary have the status of **co-manufacturers** with regard to a single insurance product, the conclusion of a written agreement between them is required under the POG rules (see Art. 3 (4) POG Regulation). The written agreement between co-manufacturers has to specify:

- the collaboration between the insurer and the intermediary with regard to compliance with the POG rules applying to manufacturers;
- the procedures on which they agree regarding the identification of the target market; and
- their respective roles in the product approval process.

Documentation of the status as distributor | If an intermediary who collaborates with an insurer is not exactly sure about its role with regard to the POG rules, but intends to keep its POG efforts as low as possible, the safest option for such an intermediary is to clearly structure and document its role as only carrying out distribution activities and to find, if possible, a written agreement with the insurer, showing as clearly as possible the decision-making role of the insurer with regard to the essential features and main elements of the relevant insurance products.

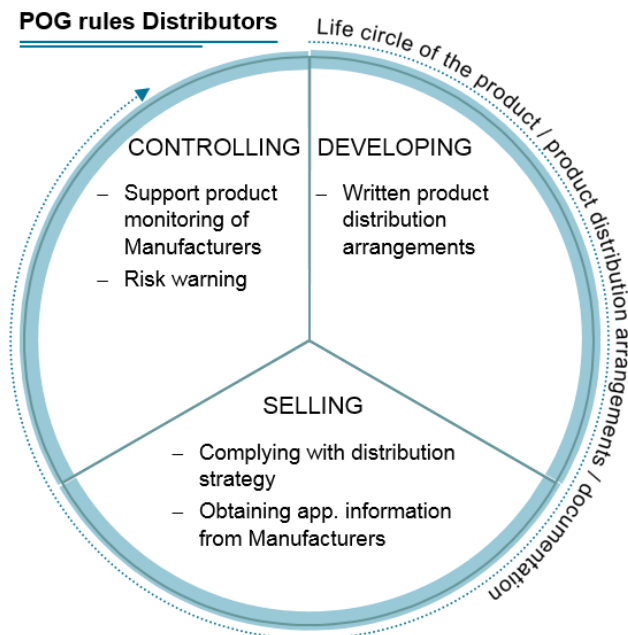


POG rules for distributors

Relevance for distributors and manufacturing distributors

If, according to the overall analysis, intermediaries are not described as manufacturers but as distributors, such intermediaries generally need to observe only the POG rules for distributors of the POG Regulation. In most of the cases, this should be the basic situation intermediaries will have to consider with regard to their business organisation after the POG rules come into force.

However, in those cases in which it is determined in the context of the described analysis that intermediaries have the status as manufacturers, this does not mean that only the POG rules for manufacturers apply to such intermediaries and that the POG rules for distributors are irrelevant for them. As already described with regard to manufacturing distributors (i.e., where intermediaries have different business units and one of the business units manufactures a product which is then distributed by another business unit), it is reasonable that the distributing business unit should comply with the POG rules for distributors (with regard to manufacturing distributors see above).





Product distribution arrangements

The POG rules provide that distributors should have product distribution arrangements in place. These arrangements must contain appropriate measures and procedures:

- to obtain from the manufacturer all appropriate information on the insurance products they intend to offer to their customers, and
- to fully comprehend those insurance products (Art. 10 (1) POG Regulation).

The arrangements concerned must be set out in a written document which the distributor must make available to their relevant staff (Art. 10 (1) POG Regulation).

Product distribution arrangements in form of internal business guidelines/instructions and in form of additional agreements with manufacturers | The written product distribution arrangements can initially be understood as measures and procedures with regard to the business organisation of distributors, ensuring, in particular, that the intermediaries and their relevant staff possess and fully comprehend/understand the relevant POG information (see below for further details) concerning the products distributed (see Art. 8 (3) (a) POG Regulation).

In this regard, it seems to be reasonable for intermediaries who are distributors to establish, in particular, internal business guidelines or business instructions based on which their staff can align their distribution activities with regard to the POG requirements applicable to distributors.

As another form of product distribution arrangements, it seems to be reasonable that, in addition to establishing internal business guidelines and instructions, distributors moreover agree with manufacturers on provisions according to which the manufacturers must provide and explain to the intermediaries all of the relevant POG information (clear, complete and up to date) in a comprehensible form. Such arrangements could be made, for example, in agency agreements or brokerage agreements concluded between intermediaries in the role as distributors and insurers or other manufacturers. In this respect, amendments to existing agency agreements and brokerage arrangements can also be considered.

Content and aims of product distribution arrangements

The POG rules request that the product distribution arrangements will, in particular, ensure that the distributors, or respectively their relevant staff, obtain from the manufacturers, in particular, **clear, complete and up to date POG information** on:

- the target market identified by the manufacturers and
- the distribution strategy suggested by the manufacturers (regarding the target market and the manufacturers' distribution strategy see POG requirements for manufacturers below)
- including
 - information on the main features and characteristics of the insurance products,
 - their risks and costs (including implicit costs), and
 - any circumstances which might cause a conflict of interest to the detriment of the customer (see Art. 10 (3) in connection with Art. 8 (2) POG Regulation).

Distribution strategy of the distributors | The POG rules request that any specific distribution strategy set up or applied by the distributors must be in accordance with the distribution strategy set up and the target market identified by the manufacturers (Art. 10 (4) POG Regulation). Therefore, the distribution strategy set up or applied by the distributors should be in line with the distribution strategy set up and the target market identified by the manufacturers.

Furthermore, the requested product distribution arrangements should:

- aim to prevent and mitigate customer detriment,
- support a proper management of conflicts of interest,
- ensure that the objectives, interests and characteristics of customers are duly taken into account (Art. 10 (2) POG Regulation).

Drafting business guidelines or business instructions | A written business guideline or business instruction concerning POG requirements for distributors could in particular request from the relevant departments and/or staff of the intermediary to obtain from the manufacturers all relevant information required to fully understand the products intended to be distributed, including, in particular, information on the target market identified and the distribution strategy suggested by the manufacturers.



Further, the guidelines/instruction can as the case may be already provide guidance on concrete measures as to how the aims shall be pursued to prevent and mitigate customer detriment, to support the proper management of conflicts of interest, and to ensure that the objectives, interests and characteristics of customers are duly taken into account.

With regard to both the POG information to be obtained from the manufacturers and the aims to be pursued by the distributors concerning the POG requirements, the guideline/instruction should address as well the products and distribution situations which are relevant to the respective intermediary. Moreover, the guideline/instruction should also deal with the aspects of documentation, internal responsibilities and reporting lines as well as the review of the product distribution arrangements and documentation requirements (for further details regarding these aspects see below).

Responsibilities and review of product distribution arrangements

According to the POG rules, the internal body or structure responsible for insurance distribution must endorse and will be ultimately responsible for establishing, implementing and reviewing the product distribution arrangements; in addition, it must continuously verify internal compliance with those arrangements (Art. 10 (5) POG Regulation).

Continuous verification? | Distributors should follow-up on which view the national regulators and courts will take in particular with regard to the following. The requirement to continuously verify internal compliance with product distribution arrangements is not further defined in the POG Regulation. Therefore, legal uncertainty exists as to what temporal requirement exactly applies with regard to the verification of compliance with the product distribution arrangements. In the event it would be requested to verify the product distribution arrangements actively, for example, on a daily basis or for each policy sale, there is good reason to believe that this is not in line with the principle of proportionality. Initially, the position could be taken that it should generally be sufficient if the internal body or structure responsible for insurance distribution assures that the staff distributing the insurance products is under the obligation to continuously comply with the product distribution arrangements in their everyday business and that the staff is aware of this duty. Whether the duty is fulfilled can then be checked by an internal body or structure on a regular basis.

The distributors shall further regularly review their product distribution arrangements with regard to validity and up-to-dateness. In particular, they must verify that the insurance products are distributed to the identified target market. Depending on the outcome of the review of the product distribution arrangements, the distributors must amend the product distribution arrangements, in particular, with regard to the specific distribution strategy (Art. 10 (6) POG Regulation).

Distribution outside the target market | The general approach of distributing products to a target market identified by the manufacturers should, in any case, not be misunderstood in terms of a prohibition for distributors to sell their products outside this target market. The POG rules do not prevent the distribution of insurance products by intermediaries to customers who do not belong to the target market identified, provided that the individual assessment at the point of sale justifies the distribution. This is the case when the products correspond to the demands and needs of the relevant customers and, where applicable, IBIPs are suitable or appropriate for the customer (with regard to the latter see the briefing note on IBIPs) (see Recital 9 POG Regulation). In this regard, it is, however, reasonable, especially with regard to situations where intermediaries distribute their products outside the target market identified by the manufacturers, to carefully document the assessment conducted at the point of sale.

Documentation

The POG rules not only require that the product distribution arrangements taken must be made in writing, but also that other relevant actions (e.g. review) taken by the distributors in relation to their product distribution arrangements must be duly documented and kept for audit purposes and made available to the competent authorities upon request (Art. 12 the POG Regulation).

Product distribution arrangements and principle of proportionality

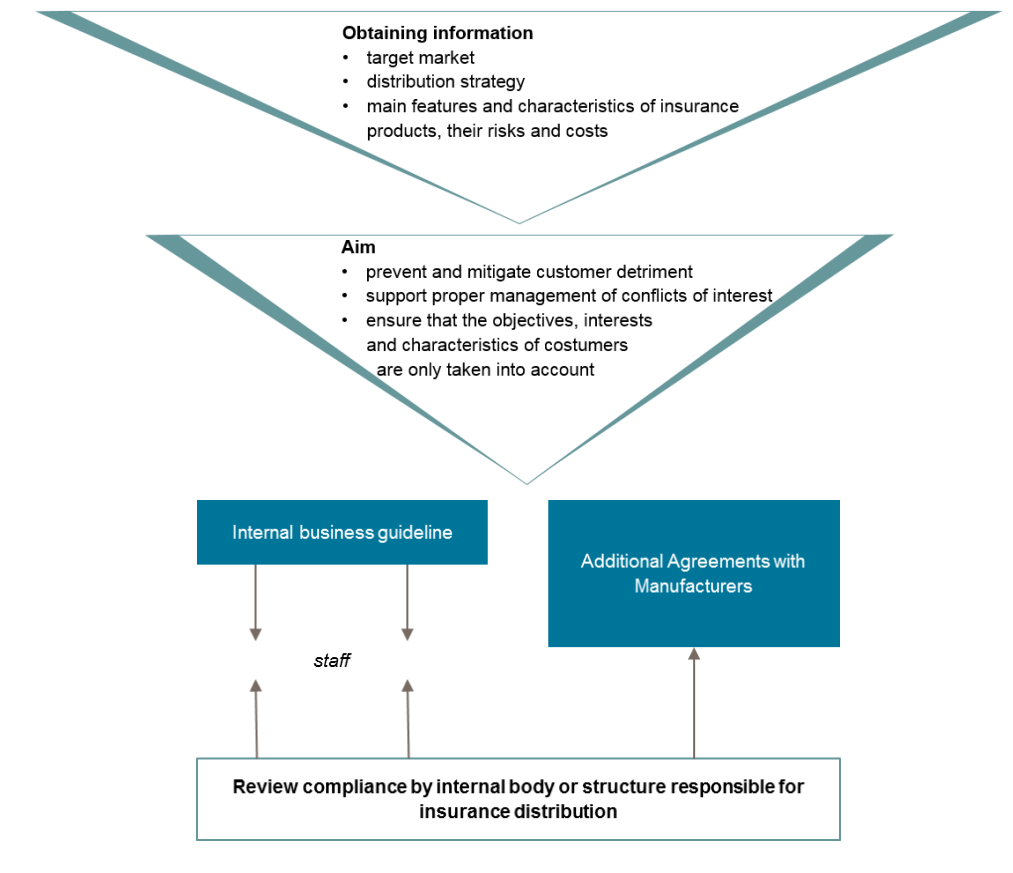
In accordance with the principle of proportionality, the content and scope of the product distribution arrangements should take into account the level of complexity and the risks related to the products as well as the nature, scale and complexity of the relevant business of the distributor (Art. 10 (1) POG Regulation).



Case study | With regard to the principle of proportionality, the product distribution arrangements (in particular in terms of the described business guidelines or business instructions) can be relatively straightforward for non-“complex” products that are compatible with the needs and characteristics of the mass retail market (e.g. current non-life insurance products with a limited, easily understandable scope).

More exacting product distribution arrangements and business guidelines or business instructions must be ensured for “complex” products with a higher risk of consumer detriment. In accordance with the principle of proportionality, the distributors must also determine the appropriate intervals at which their product distribution arrangements are regularly reviewed, taking into account the size, scale and complexity of the different insurance products involved (see above).

**Product Distribution Arrangements
Art. 10 (1) POG Regulation**



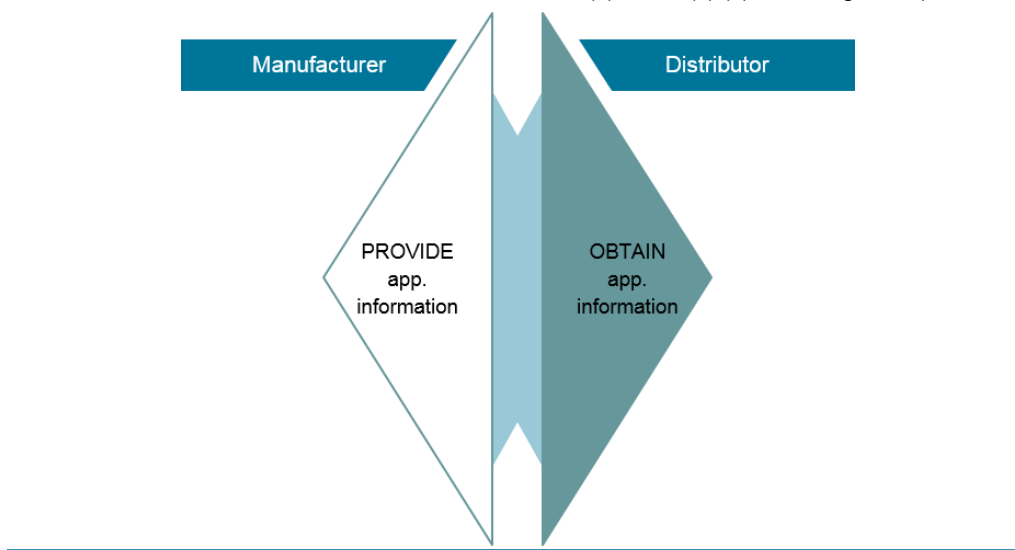


Information exchange between manufacturers and distributors

With regard to ensuring the efficient functioning of the POG obligations, the POG rules, for one, require the distributors to obtain particular POG information (see below) from the manufacturers (Art. 10 (3) POG Regulation). For another, the POG rules also demand that the manufacturers provide the relevant POG information to the distributors (Art. 8 (2) POG Regulation).

Distributors have to obtain from manufacturers/ manufacturers have to provide to distributors:

- all appropriate information on the insurance products, including
 - main features and characteristics
 - risks and costs (including implicit costs)
 - any circumstances which might cause a conflict of interest to the detriment of the customer (Art. 8 (2) POG Regulation).
- the identified target market (see below),
- the suggested distribution strategy (see below) (Art. 10 (3), Art. 8 (2) (3) POG Regulation).



However, the information exchange required under the POG rules is not a one-way street. Accordingly, distributors are also asked to provide particular information to the manufacturers.

Distributors have to provide manufacturers:

- on request with all relevant sales information (information re. the specific product), including, where appropriate, information on their reviews of the product distribution arrangements (Art. 10 (6) POG Regulation);

- information if they become aware that the manufacturer's product is not in line with the requirements set by the manufacturer (Art. 11 POG Regulation).

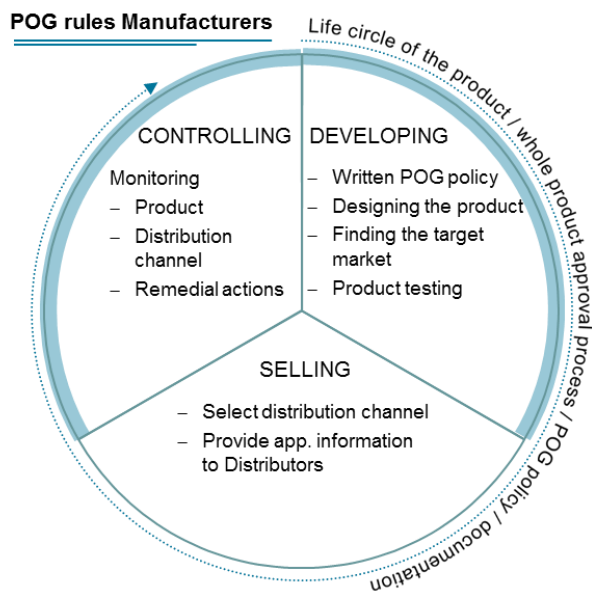


POG rules for manufacturers

Direct relevance for manufacturers and manufacturing distributors and indirect relevance for distributors

In the event the described overall analysis shows that an intermediary is the manufacturer or a manufacturing distributor (with regard to manufacturing distributors see above) of an insurance product, the intermediary needs to observe the POG rules for manufacturers.

However, also with regard to intermediaries that are distributors and as such must generally only comply with the POG rules for distributors (see above), the POG rules for manufacturers are at least of indirect relevance. Since the product distribution arrangements, which distributors are required to put in place, are primarily based on the target market identified and the distribution strategy suggested by the manufacturers in accordance with the POG rules applying to manufacturers, it is reasonable as well for distributors to also have knowledge and an understanding of the POG rules for manufacturers. This applies either with regard to the described reciprocal exchange of information between manufacturers and distributors and vice versa. Therefore, the following descriptions are of interest not only for manufacturers but also for distributors.



Product approval process and POG policy

The POG rules require that intermediaries as manufacturers maintain, operate and review a product approval process (**PA process**) with regard to products newly developed or existing products significantly adapted after the POG rules come into force (see Art. 4 (1) POG Regulation).

Functions of the PA process are:

- to ensure that the customer's demands, needs and financial situation are duly taken into account already at the stage when the insurance products are designed and manufactured,
- to meet the needs of one or more identified target markets,



- to make sure that products are sold to customers in the target market by appropriate distribution channels,
- to deliver fair outcomes for customers,
- to prevent or mitigate customer detriment,
- to support proper management of conflicts of interest (see Art. 4 (3) POG Regulation).

For this purpose, the POG rules require the manufacturer to set up a written POG policy in which the PA process is laid down, containing guidance on:

- how to design and develop the insurance product,
- how to find the target market,
- how to test the product,
- how to find the distribution channel and strategy,
- how to inform the distributor,
- how to monitor and review,
- how to define remedial actions,
- how to identify the person responsible for the product approval process,
- how to make the document available to the relevant staff,
- how to review the product approval process, frequently, if necessary, improve the process.

The written POG policy must be made available to the relevant staff (see Art. 4 (2) POG Regulation).

The POG rules further require manufacturers to regularly review and, if necessary, amend their PA process with regard to validity and up-to-dateness as set out in the POG policy (see Art. 4 (3) POG Regulation).

With regard to the PA process, it is further necessary for manufacturers to identify the body or structure ultimately responsible for:

- establishing, implementing and reviewing the process,
- continuously verifying internal compliance with the process (Art. 4 (4) POG Regulation).

In this regard, it should be noted as well that the POG rules provide that manufacturers who instruct a third party to design products on their behalf remain fully responsible for compliance with the PA process (Art. 4 (5) POG Regulation).

Further, manufacturers also have to ensure that the members of staff involved in designing and manufacturing

insurance products have the necessary skills, knowledge and expertise to properly understand the insurance products sold and the interests, objectives and characteristics of the customers belonging to the target market (Art. 5 (4) POG Regulation).

Business guideline or business instruction with regard to the PA process | The POG policy can be seen as a measure within the general business organisation of insurers and intermediaries manufacturing insurance products. As such the establishment of a POG policy basically concerns the set-up of a written internal business guideline or business instruction with regard to the entire PA process. Based on such a guideline/ instruction, the manufacturers' business organisation in terms of POG could be structured.

It is generally reasonable that the business guideline or business instruction establishing the POG policy should consider and address all the relevant aspects of the PA process, including the identification of the target market and the distribution strategy, the product testing, the product monitoring and review and the selection of distribution channels as well as the responsibilities and documentation requirements (for further details regarding these aspects see below). Moreover, the POG policy should as far as possible consider and make reference to the current and intended future product portfolio and the manufacturer's relevant distribution situations.

Intermediaries who manufacture insurance products or who in the future intend to manufacture such products in the described meaning should therefore already consider how to draft and set up such a business guideline or business instruction concerning their PA process. This applies as well if a specific new development or adaptation is not planned in the short term but, for example, in the mid term after the POG rules have come into force.

PA process and principle of proportionality

In accordance with the principle of proportionality, the content and scope of the measures and procedures of the PA process must be proportionate to the level of complexity and the risks related to the products as well as the nature, scale and complexity of the relevant business of the manufacturer.



Case study | With regard to the principle of proportionality, the PA process and its different elements as well as the POG policy can be relatively straightforward for non-“complex” products that are compatible with the needs and characteristics of the mass retail market (e.g. current non-life insurance products with a limited, easily understandable scope) (see Recital 2 POG Regulation). A more exacting PA process must be ensured for “complex” products with a higher risk of consumer detriment.

This abstract description of a compatible group specifying the target market has to be distinguished from necessary individual assessments with regard to individual customers at the point of sale (e.g. whether an insurance product meets a customer’s demands and needs or whether an IBIP is more suited or appropriate for the individual or potential customer).

Identification of a target market compatible with the product

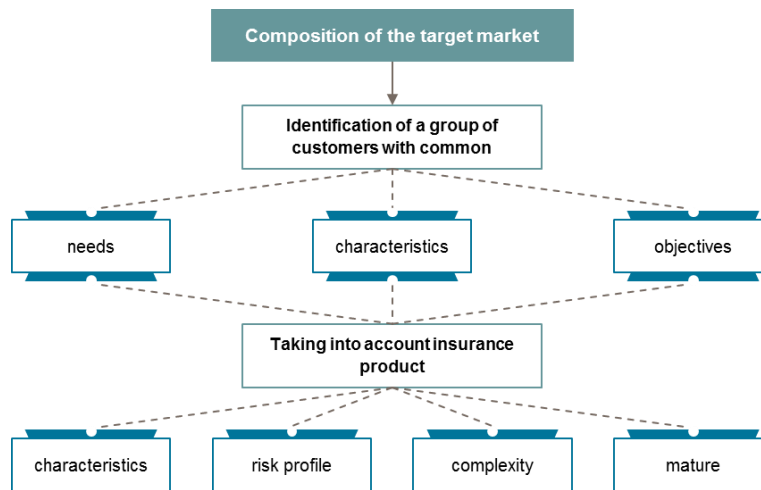
According to the POG rules, manufacturers will, in particular, have to identify the target market of the product within the context of the PA process of a specific product (Art. 5 (1) POG Regulation). Identifying the target market is supposed to enable the manufacturers to adapt the features of the product to the relevant target market and to determine the appropriate distribution strategy.

The POG rules provide that a manufacturer may only design and market insurance products that are compatible with the target market (Art. 5 (3) POG Regulation). When identifying the target market, intermediaries as manufacturers will therefore also have to assess the compatibility of the target market with the product and should document this assessment.

According to this, intermediaries as manufacturers will need to identify and document the target market for all newly developed insurance products and for all significant adaptations of existing insurance products after the POG rules come into force.

Distribution outside the target market? | As indicated above, the requirement to identify and observe the target market should in any case not be misunderstood in terms of a prohibition to sell products outside the target market in particular cases. The POG rules do not prevent the distribution of insurance products to customers who do not belong to that 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. In the event that IBIPs are distributed outside the target market, it needs to be further ensured that they are suitable or appropriate for the customer (with regard to the latter see the briefing note on IBIPs) (see Recital 9 POG Regulation).

How is the target market to be identified? | An abstract description of a group of compatible customers is required. On a generalised level, potential customers thus have to be identified and described with regard to common requirements as a group.





Examples for questions regarding the assessment of compatibility of the target market with the product:

How complex is the product and which level of information, knowledge and understanding of the product is available to customers belonging to the relevant target market?

What are the pricing requirements of the product and what degree of financial literacy do the customers in this target market have?

Is the product suitable, e.g., for the life situation, risk tolerance, coverage needs and objectives, etc., of the customers in this target market?

According to the POG rules, identifying a target market that is compatible with the product may also include, in particular with regard to IBIPs, specifying groups of customers for whom the product is not compatible (Art. 5 (2) POG Regulation).

Development of a distribution strategy

In connection with the identification of a target market, it can already be concluded from the IDD that within the context of the PA process a distribution strategy for new or significantly adapted products needs to be developed, which must be consistent and appropriate with the identified target market (see Art. 25 (1) IDD).

Product testing

According to the POG rules, manufacturers must also appropriately test new insurance products within the context of the PA process regarding a specific product before bringing them to the market or significantly adapting a product already on the market. Within the context of product testing, it must be assessed whether the insurance product over its lifetime will meet the identified needs, objectives and characteristics of the target market. The product must also include a scenario analysis, where relevant (Art. 6 (1) POG Regulation).

The POG rules request that manufacturers do not bring insurance products to the market if the results of the product testing show that the products do not meet the identified needs, objectives and characteristics of the target market (Art. 6 (2) POG Regulation).

According to this, intermediaries as manufacturers will need to conduct and document product testing for all newly developed insurance products and for all significant adaptations of existing insurance products after the POG rules come into force.

Changes in the target market | The POG rules provide that product testing must also take place in the event the target market has significantly changed (Art. 6 (1) POG Regulation). According to this, it seems reasonable to assume that product testing is also necessary in the event the product is not adapted significantly but sold to other groups of customers.

This results in legal uncertainty with regard to insurance products that are brought to the market before the POG comes into force and remain unchanged; the POG requirements should generally not apply to such products (see above). With regard to such products, taking into consideration the denoted provision, there is a risk that the POG rules could be applicable if an unchanged product is merely sold to another group of customers. Currently, it cannot be excluded that such a change to the distribution strategy of the product and not to the product itself could be seen as a significant product adaptation for which a PA process is necessary.

Product testing taking into consideration the nature of the insurance product

The POG rules provide that manufacturers must at least test the relevant insurance product in a qualitative manner. However, the POG rules further provide that, depending on the type and nature of the insurance product and the related risk of detriment to customers, a relevant insurance product should be tested in a quantitative manner as well (Art. 6 (1) POG Regulation).

Quantitative product testing, including the assessment of the product performance and risk/reward profile, is required, in particular, for IBIPs. It is, however, impermissible that such a test interferes with the manufacturers' freedom to set premiums or leads to price control in any form (Recital 8 POG Regulation).

Further, particularly with regard to IBIPs, the requirement to carry out the scenario analysis also applies. However, for non-life insurance products a scenario analysis should only be necessary to an extent proportionate to the complexity of the product, its risks and the relevance of external factors with respect to the product performance.



Product monitoring and review

According to the POG rules, manufacturers must within the context of the PA process continuously monitor and regularly review the insurance products they have brought to the market during their lifetime. The aim of product monitoring is to identify events that could materially affect the main features, the risk coverage or the guarantees of the products (Art. 7 (1) POG Regulation).

Product monitoring and review requires intermediaries as manufacturers to assess whether an insurance product newly developed or significantly adapted after the POG rules come into force remains consistent with the needs, characteristics and objectives of the identified target market and whether such products are distributed to the target market or reach customers outside the target market.

Examples for questions regarding product monitoring and review

- Have the market conditions or political and social situations of the target market changed?
- Has the risk/reward profile changed?

Has the tax environment changed?

Principle of proportionality | The principle of proportionality is also of particular relevance for the scope and interval of product monitoring and review. The POG rules provide that manufacturers must determine the appropriate intervals at which to carry out the regular review of their insurance products, taking into account

- the size of the product,
- the scale of the product,
- the contractual duration,
- the complexity of product,
- the distribution channels,
- any relevant external factors such as changes to the applicable legal rules, technological developments, or changes to the market situation (Art. 7 (2) POG Regulation).

Particularly with regard to IBIPs, closer product monitoring in reasonably short intervals seems appropriate.

Remedial actions

The POG rules provide that a manufacturer who within the context of product monitoring determines circumstances related to the insurance product that may adversely affect the customer of that product must take appropriate remedial actions to mitigate the situation and prevent further occurrences of the detrimental event (Art. 7 (3) POG Regulation).

Examples for remedial actions after identification of an adverse effect within the context of product monitoring and review are:

- informing the distributor about deficits of the product,
- informing the customer about deficits of the product,
- contacting the distributor to discuss modifying the distribution process,
- changing the product approval process,
- changing the product,
- changing the target market,
- proposing a new product to the customers in the target market,
- stopping further issuance of the product,
- terminating the relationship with the distributor,
- informing the relevant competent authority.

Product monitoring and review for all products brought to the market? | The POG rules address the product monitoring for insurance products brought to the market in general terms; legal uncertainty exists as to whether the POG measure of product monitoring could apply also to products that were brought to the market before the POG rules come into force and have remained unchanged. As already described, POG rules should generally not be relevant with regard to such products (see above). However, especially with regard to IBIPs, it can not be excluded that national lawmakers, regulators or courts may request, in particular, that product monitoring and review be carried out also with regard to products brought to the market before the POG rules come into force.



Distribution channels

According to the POG rules, manufacturers must carefully select their distribution channels within the PA process for products newly developed or significantly adopted. Taking into consideration the particular characteristics of the relevant insurance products, the distribution channels selected need to be appropriate for the target market (Art. 8 (1) POG Regulation).

Considerations with regard to distributors | In the event intermediaries as manufacturers sell newly developed or significantly changed insurance products through other intermediaries as distributors, the intermediaries should consider and ensure that the distributors have the necessary knowledge, expertise and competence to understand the features of the insurance product and the identified target market.

Monitoring of distribution channels

The POG rules further provide that manufacturers must take appropriate steps to monitor that the distributors act in accordance with the objectives of the PA process and, in particular, that the products are distributed to the identified target market (Art. 8 (4) POG Regulation).

Reasonable monitoring | There is good reason to believe that the required monitoring of distribution channels by manufacturers should not be misunderstood as a general material supervision requirement and supervision right of manufacturers over distributors. In particular, there is no foundation for a duty or right based on which the manufacturers, e.g., may request information or access to records with regard to internal matters and other business transactions of the distributors. From the outset, monitoring the manufacturers' distribution channels has to be limited to activities aimed at checking that the distributors act in a manner which is in line with the objectives of the manufacturers' PA process. Further, the scope of the monitoring conducted by manufacturers must in any case be reasonable, taking into consideration the characteristics and the legal framework of the respective distribution channels (Art. 8 (4) POG Regulation).

Remedial actions

In the event intermediaries as manufacturers sell relevant products through other intermediaries as distributors, the POG rules require that if they consider the distribution of their insurance products not to be in accordance with the objectives of the PA process, they must take appropriate remedial action (Art. 8 (5) POG Regulation).

Reasonable remedial actions | As is the case with monitoring activities, it has to be assumed that the remedial actions addressed by the POG rules also need to be reasonable, taking into consideration the characteristics and the legal framework of the respective distribution channels. Therefore, manufacturers should be under an obligation to carefully select remedial actions and not to apply excessive measures. Remedial actions should initially consist in the manufacturers instructing the distributors to stop a distribution practice which is actually not in line with the objectives of the PA process.

With regard to monitoring distribution channels and remedial actions, manufacturers should further note, in particular, that the distribution of the products outside the target market is not generally critical. Distributing products to customers not belonging to the target market may still be unproblematic if the individual assessment at the point of sale justifies the distribution (see above). In such cases, no remedial actions are necessary and need to be taken.

Documentation

The POG rules not only require that the POG policy is set out in writing, but also that the other relevant actions taken by manufacturers in relation to their PA process (i.e. identification of the target market, product testing, product monitoring and review, selection of distribution channels) are duly documented, kept for audit purposes and made available to the competent authorities upon request (Art. 9 POG Regulation).

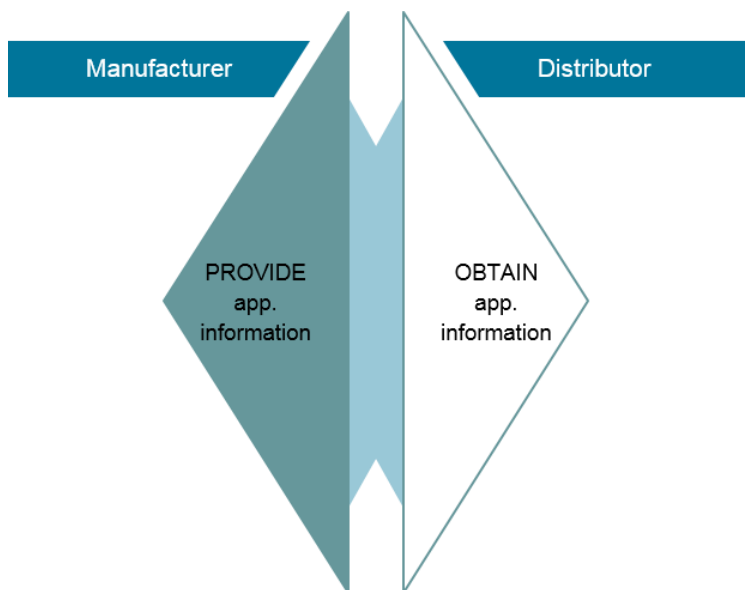


Information exchange between manufacturers and distributors

As already described with regard to ensuring the efficient functioning of the POG obligations, the POG rules, for one, require manufacturers to provide particular POG information to the distributors (Art. 8 (2) POG Regulation). For another, the POG rules also request distributors to obtain the relevant POG information from manufacturers (Art. 10 (3) POG Regulation).

Manufacturers have to provide distributors with/ distributors have to obtain from manufacturers:

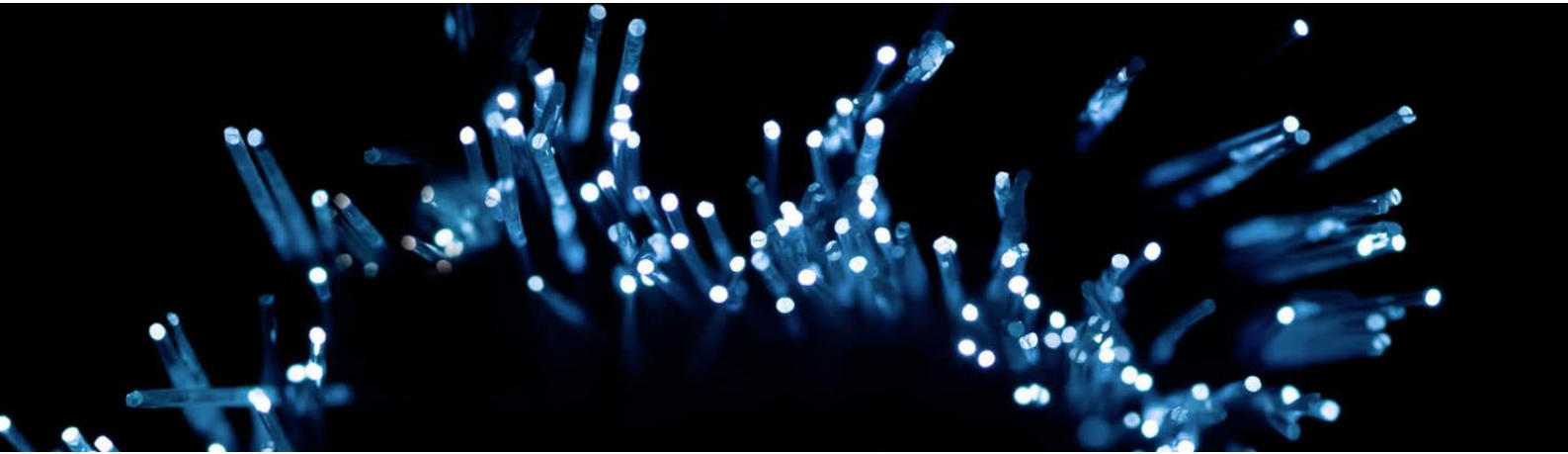
- all appropriate information on the insurance products, including
 - main features and characteristics,
 - risks and costs (including implicit costs),
 - any circumstances which might cause a conflict of interest to the detriment of the customer (Art. 8 (2) POG Regulation).
- the identified target market (see above),
- the suggested distribution strategy (see above) (Art. 8 (2) (3) POG Regulation).



As also indicated above, however, the information exchange required under the POG rules is not a one-way street. Accordingly, distributors are also asked to provide particular information to manufacturers.

Distributors have to provide manufacturers:

- on request with all relevant sales information, including, where appropriate, information on their reviews of the product distribution arrangements (Art. 10 (6) POG Regulation);
- with information, if they become aware that the manufacturer's product is not in line with the requirements the manufacturer has given (Art. 11 POG Regulation).



Overview POG

