

Insurance Distribution Directive and digital transformation

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Abstract

The elaboration process of the Insurance Distribution Directive (IDD) took place in parallel with the developments of new technologies' applications to insurance – Insurtech- and, therefore, does not put Insurtech as the core of its rules. Nonetheless, the IDD appears to be able to regulate many of the emerging legal issues concerning digital distribution models, while the most insidious regulatory challenges consist of aligning the upcoming general regulatory framework on digital transformation to the insurance sector's peculiarities.

Key words: Insurance distribution, InsurTech, Online insurance, Digital transformation

1. INTRODUCTION

The Commission issued the draft proposal to reform the Directive 2002/92/EU on insurance mediation (IMD) in July 2012. The Directive 2016/97/EU of 20 January 2016 on insurance distribution (IDD) is the outcome of that legislative process requiring the Member States to implement it by 23 February 2018. Some issues were not clearly defined or even predictable when the IDD was drafted and approved following a three- and half-year legislative process. The elaboration process of the IDD took place in parallel with the developments of new technologies' applications to insurance – Insurtech- and, therefore, does not put Insurtech as the core of its rules.

Nonetheless, the IDD appears to be able to regulate many of the emerging legal issues concerning digital distribution models. Principles and rules introduced by the IDD are flexible enough to govern how manufacturers and distributors must design and distribute insurance products following the digital transformation. Therefore, a proper interpretation of the regulatory framework established by the IDD excludes, in principle, the need for new rules.

On the other hand, the European Commission has taken numerous steps to fully comprehend and evaluate the FinTech phenomenon and its implications for the financial services sector after the adoption of the IDD. To this end, one of the most

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relevant papers issued by the European Commission is the FinTech Action Plan in 2018, in which the European Union acknowledged that Fintech presents both opportunities and challenges for regulatory compliance and supervision. There was also a recognition that Europe's regulatory and supervisory frameworks should allow firms operating in the European Union Single Market to benefit from financial innovation to safely provide their customers with the most suitable and accessible products. Moreover, such frameworks should also ensure a high level of consumer and investor protection and ensure the resilience and integrity of the financial system.

The following paragraphs will (1) analyze how the IDD deals with the issues arising from the InsurTech, and (2) provide an overview of the upcoming EU regulation on digital transformation to assess how it is aligned with the IDD's scope.

2. THE RESILIENCE OF THE IDD: COMMERCIAL COMPARISON WEBSITES

The IDD's ability to regulate digital distribution models is evident in several respects. To begin, the commercial comparison websites are the oldest form of distribution channel arising from InsurTech. The IDD does not provide any definition of comparison websites, but the distribution of insurance products includes the activities carried out by comparison websites. Entities performing the comparison can be qualified as insurance intermediaries or ancillary insurance intermediaries, and they fall within the scope of the IDD (Marano, 2019, 298). Moreover, the definition of insurance distribution refers to „websites or other media” and, therefore, includes both traditional comparison websites and the alternative models of comparison such as the price comparison apps for smartphones and the data analyzer services (Marano, 2019, 300; Marano, 2016, 75 ff).

EIOPA issued Good Practices on comparison websites before the IDD (EIOPA, 2014). These practices are expected to be adopted by the relevant market players voluntarily and may serve as a reference for further work by national competent authorities (EIOPA, 2014, 6). They aim to promote transparency, simplicity, and fairness for Internet users in the market for online comparisons of insurance products. Although these practices predate IDD, they complement the Directive's general principles and standards, such as the duty of disclosure for insurance distributors, the principle of acting in the best interest, and cross-selling (Marano, 2019, 300 ff).

2.1. Peer-to-peer insurance

Another digital distribution model is peer-to-peer. EIOPA promoted a survey among the national competent authorities to understand if and how to regulate peer-to-peer insurance. The analysis surveyed the three peer-to-peer models already operating in some of the Member States: the peer-to-peer broker model, the peer-to-peer insurance model, and the self-governing model (Braun, Schreiber, 2017). EIOPA concluded that peer-to-peer platforms operating under the broker model and the insurance model would be licensed as an insurance intermediary or insurance undertaking, respectively, and consequently follow all insurance regulations (EIOPA, 2019). By contrast, the IDD

does not provide specific rules on the entities managing the self-governing activity, or the activity itself. Thus, EIOPA issued best practices addressed to such pure peer-to-peer insurance platform providers, which are not easy to classify under the current regulation as they operate under a self-governing model (EIOPA, 2019, 26).¹

To sum up, the IDD's rules should address the legal issues arising from two peer-to-peer models as the entities managing these models fall into the IDD scope (Clemente, Marano, 2020, 461 ff; Ostrowska, Ziemak, 2020, 43 ff; Marano, 2019, 305 ff). New rules should regulate the self-governing model as it falls outside insurance distribution, i.e., it is unrelated to insurance products (Lima Rego, Campos Carvalho, 2020, 42).

2.2. Robo-advisers

Robo-advisers are the most recent digital insurance intermediaries. The IDD does not introduce specific rules for this activity. Nevertheless, legal entities carrying out their activity through Robo-advice systems fall into the scope of the IDD in principle because they are distributing insurance products (Marano, 2019, 309 f.). The IDD provides standards on both the intermediaries and the advice (Directive (EU) 2016/97, art. 2(1), n.(15), 18, 19(1)(c), 20).² These standards also apply to those who are carrying out their activity through the provision of Robo-advice (Ostrowska, Balcerowski, 2021, 203 f.).

The distributors' responsibility to perform the suitability assessment "shall not be reduced due to the fact that advice on insurance-based investment products is provided in whole or in part through an automated or semi-automated system" (Commission Delegated Regulation (EU) 2017/2359, art. 12).³ This principle is expressly established for the distribution of insurance-based investment products (IBIPs). Strictly speaking, therefore, no European standard establishes the application of this principle for the other life and non-life insurance products. However, national laws (and Courts) can extend such principle to all insurance products during implementing (or interpreting) the IDD into national laws.

In favor of extending this principle to all insurance products, it can be argued that the product oversight and governance (POG) rules play an essential role in robot advice, as manufacturers must monitor how algorithms process their products when distributed by intermediaries that manufacturers have selected as adequate for distributing through this tool (Marano, 2019, 313 ff.). This monitoring must also be carried out when insurance products are sold with advice, regardless of whether (i) the advice is provided in a "traditional" way or through automated or semi-automated systems, (ii)

¹ *Report on best practices on licencing requirements, peer-to-peer insurance and the principle of proportionality in an insurtech context*, outlined that it is the matter of evaluating concrete business models and the outcome can be that it is also operating under insurance regulation, or it is outside of the regulation, e.g., more in the context of payments services, for instance.

² And, limited to insurance-based investment products, art. 29 and 30 of the IDD.

³ Recital No. 10 of Commission Delegated Regulation (EU) 2017/2359 provide for the rationale behind this rule: "since such systems are providing personal investment recommendations which should be based on a suitability assessment."

the products are insurance-based investment product or other life or non-life insurance products.

3. THE NEW REGULATORY FRAMEWORK ON THE DIGITAL TRANSFORMATION: THE EU DIGITAL STRATEGY

IDD's resilience requires to be evaluated within the EU regulatory framework on digital transformation. Although this regulatory framework that is being defined does not expressly concern the insurance market, it is likely to influence insurance companies and intermediaries. The definition of this framework is still in progress. Even if some legislative provisions have entered into force, the deadline for their effectiveness has not yet come. Thus, we can only provide a hint here.

Europe's digital transformation, i.e. "A Europe fit for the digital age", is one of the Commission's six Political Priorities (European Commission, 2019a). The EU's digital strategy falls within the digital transformation and aims to make this transformation work for people and businesses. According to this strategy, the Commission is determined to make this Europe's "Digital Decade", with a clear focus on data, technology, and infrastructure (European Commission, 2019b). The actions that should achieve this goal include the following:

The Digital Market Act (Regulation /EU/ 2022/1925), entered into force on 1 November 2022, which sets forth objective criteria for qualifying a large online platform as a "gatekeeper", including those platforms providing online intermediation services, and establishes obligations for these gatekeepers, "do's" and "don'ts" they must comply with their daily operations.

The Digital Services Act (Regulation (EU) 2022/2065), entered into force on 16 November 2022, which defines responsibilities and accountability for providers of intermediary services, particularly online platforms such as social media and marketplaces.

An EU strategic framework based on fundamental values aims to give citizens the confidence to accept AI-based solutions while encouraging businesses to develop them (European Commission, 2021).⁴

A European data strategy, to create a single market for data where data can flow freely within the EU and across the sectors, European rules, in particular privacy and data protection, as well as competition law, are fully respected, and the rules for access and use of data are fair, practical, and clear (European Commission, 2020e). Such a strategy led to the Data Governance Act (Regulation (EU) 2022/868).

Ambitious Europe's "Digital Decade", including cybersecurity (European Commission, 2020c) and E.Identities (Regulation (EU) No 910/2014) and coherent with the Regulation for business users of online intermediation services (Regulation (EU) 2019/1150), ran parallel to the Digital Finance Package the European Commission adopted on 24 September 2020, including a digital finance strategy (European Commission, 2020d), a legislative proposals on crypto-assets (European Commission, 2020f),

⁴ Such proposal follows the European Commission documents: European Commission, 2020a; European Commission, 2020b.

and the Digital Operational Resilience Act (DORA) entered into force on 16 January 2023 (Regulation (EU) 2022/2554).

3.1. The regulatory framework on digital transformation and the insurance sector

The framework of rules on the digital transformation that is being defined has also been approached by the European authorities to evaluate its impact on the banking, financial and insurance.

ESAs worked on digitalization in financial services (ESMA, EBA, EIOPA, 2019), and EIOPA focused on insurance. In recent years EIOPA has undertaken horizon scanning, publishing consultation papers, reports, and regulatory guidance on topics such as AI, cloud computing, open insurance, Blockchain or licensing requirements in an InsurTech context (EIOPA, 2019a). Moreover, EIOPA adopted a Digital Transformation Strategy (EIOPA, 2021a) and identified five key long-term priorities on digital transformation, which will guide EIOPA's contributions on digitalisation topics.⁵

Furthermore, EIOPA has organised several InsurTech roundtables and created a dedicated stakeholder expert group on digital ethics to discuss these topics from a broader perspective and developing a set of digital responsibility principles in insurance (EIOPA, 2021b).

The principles of digital responsibility will address, from a fairness / ethical perspective, the use of new business models, technologies, and data sources in insurance. They should leverage other related cross-sectorial work developed in other international fora and, where necessary, adapt them to the insurance context (EIOPA, 2019b, 3).

The IDD reveals its ability to regulate such issues. Fairness and non-discrimination in the digital context should fall within the scope of the IDD's general principle under which distributors must always act honestly, fairly, and professionally in accordance with the best interests of their customers (Directive (EU) 2016/97, art. 17). Digital responsibility is likely to include transparency as insurance distributors are required to „provide the customer with objective information about the insurance product in a comprehensible form to allow that customer to make an informed decision” (Directive (EU) 2016/97, art. 20).

4. CONCLUSIONS

IDD seems resilient to new technologies, although it could be slightly modified to better adapt to new digital scenarios. A rethinking of the pre-contractual information documents, for instance, is necessary to make them compatible with the new technologies used to conclude the contract. The most challenging risk is that the IDD can lose its centrality in regulating insurance distribution, at least the digital one. A plurality of regulatory sources could regulate such distribution. The developments in the digital

⁵ Such priorities are: (i) Leveraging on the development of a sound European data ecosystem, (ii) Preparing for an increase of Artificial Intelligence while focusing on financial inclusion, (iii) Ensuring a forward-looking approach to financial stability and resilience, (iv) Realizing the benefits of the European single market, (v) Enhancing the supervisory capabilities of EIOPA and national competent authorities.

activities' regulation should instead be adapted to the insurance business and included in the IDD. This approach would favor the harmonized implementation of insurance rules in the Member States because they would have to consider the regulatory intervention as a whole. Digital insurance distribution can increase organizational requirements but does not cancel their connection with the conduct rules. Moreover, POG requirements call to consider both to evaluate a distribution/a product as appropriate. Also, the principle of proportionality should avoid the costs of compliance with the requirements for carrying out insurance distribution in a digital environment are fatal for small and medium-sized distributors.

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