DISTRIBUTION BY BANKS & OTHER DISTRIBUTORS OF INVESTMENT POLICIES
A FOCUS ON THE DISTRIBUTED PRODUCT

Abstract

In insurance policies with investment character the insurer does not provide exclusively coverage of risks, i.e. the transfer of risks from the applicant to himself, but at the same time he provides, directly or indirectly, investment services.

This paper examines the distribution of insurance products with investment character, the professional and disclosure requirements detected by law for them, the status of investment policies distributed by insurance undertakings, insurance intermediaries, banks & other investment providers as well as the status of Policies linked with investment as part of the Packaged Retail Investment Products (PRIPs). Whilst doing so, the paper also evaluates the current and future trends regarding insurance intermediation.

Keywords: insurance, distribution, investment products, intermediation, packaged retailed investment products (PRIPs)

Overview

1. Distribution of insurance products with investment character
   1.1. Demystifying the insurance products with investment character
   1.2. Classification in EU insurance classes & regulation at EU level
2. Professional & disclosure requirements

1. DISTRIBUTION OF INSURANCE PRODUCTS WITH INVESTMENT CHARACTER

1.1. Demystifying the insurance products with investment character

In insurance policies with investment character the insurer does not provide exclusively coverage of risks, i.e. the transfer of risks from the applicant to itself, but at the same time he provides, directly or indirectly, investment services.

Policies with investment character are of two kinds. The first one consists of the so called “capital” life policies as well as the life time policies. In all cases of life insurances, where the payment of the insurance money is certain, the policies have an investment character. This is obvious, because in order for the insurer to be able to pay the insurance money both in cases where the risk has not occurred and in cases where the risk has occurred, it has to retain part of the premium, while the rest will be consumed, usually at the price set by the bearer of the risk. The collected and retained premium through the years is intended to pay the insurance money in either the case that the possibility of its repurchase is provided or in the case that the policy is stipulated for a lifetime or is a combined death and surviving policy, over a certain time. In all the above cases, the payment of the insurance money is certain and for that purpose, the retained and collected part of the premium is saved / invested by the insurer. The latter, does not simply repay the part of the premium collected and saved for the acco-
unt of the insured through the years, but, usually, also promises a guaranteed (technical) interest and, in addition, a participation of the insured to the potential capital gains of this investment.

In spite of the investment character of those policies, the insured does not buy directly investment services by the insurer; insurer's purpose remains to cover life risks. It is the nature of these policies which demands part of the premium to be collected, invested and credited in favour of the insured (forming the mathematical reserves), and not the wish of the insured to buy an investment product. The investment policy is an internal matter of the insurer.

Another kind of insurance policy with investment character is the policy linked to investments which belongs, according to EU Law, of the insurance class of «life policies linked to investment funds». These policies, indeed, have a double function: the one is the coverage of risk and the other is that of the investment services. The premium, in a whole or part of it, is invested and presented in units managed by the insurer. The value of the units depends on the value of the underlined assets. Thus, the insured, in any case, bears the investment risk insofar that he acts as an investor and as an insured. Moreover, he buys directly investment services together with insurance coverage.

Only this second category of policies with an investment character forms the category of investment policies. Some of the investment policies do not include any transfer of risk, while others do. EU Law does not prohibit insurers who sell life policies linked to investment funds not to include any risk at all, while in some EU countries, the insurers are obliged to include a risk element (e.g. in Germany this is set at the level of 10%).

Investment policies are always regarded as insurance products, even if they don't include any risk. The reason is that they are issued by the insurer. Since all investment policies are issued by insurance undertakings, they are regarded as insurance products, they are regulated by the insurance legislation and are supervised by the Superintended of Insurance and not by the Capital Market Commission. Thus, legislative and supervisor lacunae appear, as to the protection of the insured in their capacity as investors. The following questions arise:

- Should the policyholder enjoy additional protection equal to the special protection retail investors enjoy?
- Should the holder of investment policy be treated equally to the holder of non-investment policy (common policyholder)?
- Should special warnings be made to the policyholder because of his/her double capacity (assured and investor)?

1.2. Classification in EU insurance classes & regulation at EU level

According to EU Law, insurance products which are at the same time investment products (2nd category of insurance products with investment character) are only the following insurances, provided they are linked with investment funds (i.e. unit-linked):

1. Life assurance including:
   - Assurance on survival to a stipulated age only
   - Assurance on death only
   - Assurance on survival to a stipulated age or on earlier death
   - Life assurance with return of premiums
2. Annuities
3. Marriage and birth assurance

The EU law simply provides (consolidated life Directive 2002/83, annex I, no. III, art. 2 par. 1 sec. a & b and art. 25 and Directive 1991/674) some rules as to how the technical reserve and the insurance investment should be formulated in case insurances are linked with UCITS and index. Further rights and obligations of the insured, in the above classes, who at the same time acts as an investor, are not provided. National regulations fill partially this gap, and the Committee of the Insurance and Occupational Pensions Supervisors has published on 02.07.2009 a report which illustrates the considerable differences between Member-States regarding disclosure requirements and professional requirements for unit-linked life insurance products. In addition, unit-linked products are different from mutual funds. Irrespective of whether the underlying assets of the unit-linked product from an “external” mutual fund or an “internal” created by the insurer, the owner of the underlying assets is the insurance company which has only an obli-
gation towards the investor/insured; i.e. to liquidate the units when such a liquidation is either due or required, while the investors in the mutual funds have a direct access to the securities presented by their participation in the fund. However, the insurer, as stated above, has the obligation to create a technical reserve and investments for its unit-linked products. In other countries the unit-linked insured/investor has the facility to select between a large number of internal/external funds, and further on he may also select the underlying assets; however this is not an option as per EU law.

2. PROFESSIONAL & DISCLOSURE REQUIREMENTS

2.1. The protection of the retail investor and the protection of the policyholder

In order to answer the question whether the holder of an investment policy needs additional protection from that existing for the holder of non-investment policies, it is necessary to know the rules which are in place and which aim at protecting the buyers of investment products, i.e. the receivers of investment services, and which also aim at protecting the buyers of insurance products, i.e. the receivers of insurance services. In this way, differences may appear which eventually are not reasonable in so far as the investment policies are similar to other kinds of investment services for which the legislator imposes the protective rules. With regard to the legislator and the rules passed, we cannot make precise conclusions unless we analyze each and every jurisdiction. However, in light of the fact that we function within a global economy and that investment products are very innovative and sold cross-border around the globe, it follows that the multiple national rules do not anymore show as many differences as they used to do in the past, and, thus, a general common characteristic exists in all of them, which allows a brief review. Further on, we base our comments mainly on EU law since it is quite innovative and protective to the consumers and because it applies to 27 countries.

2.2. The position of the providers/distributors of investment products (investment firms)

As regards the position of providers/distributors of investment products, the following is to be mentioned: the common categories of providers and distributors of investment products acknowledged at EU level, are: Banks, Investment Firms, Investment Brokerage Firms, UCITS Management Co’s, Portfolio Investment Co’s (and not the life insurer). All of the above mentioned five categories of undertakings are entitled as per EU law (MiFID Directive 2004/39) to provide investment services and, thus, are subject to the requirements provided by the law mainly for the protection of consumers.

At national level, the protection focuses on the natural persons who provide the investment services and not merely on the professional entity for which these persons work as employees/directors, as is the case on EU level. The minimum professional requirements consist of qualifications such as adequacy, reliability, efficiency, experience and special knowledge of financial instruments - including sophisticated derivatives.

The said entities act, mainly, as direct providers of investment products, but they can also act as distributors for other providers of investment products or as simple distributors. It is only the investment brokers which act exclusively as distributors, pursuant to EU Law and more specifically the MiFID Directive.

Further, disclosure requirements concerning the product consist of a special information duty (including the categorization of clients), the conduct of appropriateness/suitability test, the use of cautionary language, the insertion of a warning that past performance does not guarantee future results (the latter being an obligation which is being imposed to UCITS Management Co.).

2.3. The position of the insurance intermediaries and of the insurance undertakings

As regards the position of insurance undertakings and of the insurance intermediaries the following should be mentioned: at EU level no requirements are provided in relation to the needed professional qualifications of the natural persons that provide insurance services as employees of insurance undertakings.

Professional qualifications are required at EU level (IMD) only for the natural persons who are responsible and in charge of the distribution of insurance products, as well as for the natural persons who actually conduct the mediation and con-
tact the applicants for the scope of the conclusion of insurances. It should be noted that the consultation for the amendment of the IMD and the relative draft projects provide similar professional requirements for the employee of the insurance undertaking who contacts the applicants and the policyholders as well. Professional qualifications are not oriented to investment policies at EU level, however a non-specialized experience and knowledge of the investment products is required. The requirements are restricted into the purely insurance aspect of the products and do not relate to their investment part. It should equally be noted that investment firms are not entitled, in the EU, to sell investment policies.

Disclosure requirements of the products exist only with regard to life insurers (EU level: Consolidated Life Directive), however, these requirements are neither the same as the disclosure requirements which exist with regard to investment products sold by investment firms, nor are their providers supervised and regulated by the same entity and legislation.

2.4. The protection of the retail investor and the protection of the policyholder

Based on the above analysis, the question which arises revolves around the issue of whether the treatment of investment policies is less protective in comparison with the treatment of investment products. In other words, the question raised is whether the protection which the holder of investment policies enjoys is minor than the protection enjoyed by the receiver of investment services.

Prior to answering the question whether we face a situation where less protection is granted for similar services, it is necessary to focus on the distributed investment policies and to compare those policies with the several kinds of investment products sold in the market. Unit-linked policies which are sold in EEA are linked with an index of shares or with investments in UCITS either external i.e. UCITS managed by special UCITS Management Co’s, or internal, i.e. those managed by insurance undertakings. Thus, the policyholder who buys from an insurance undertaking/insurance intermediary unit-linked products, receives simple investment services because the unit-linked products do not include complicated and sophisticated financial products (such as derivatives, swaps, options, etc.) that an investment company is entitled to sell. The existing professional requirements for the sellers of unit-linked policies are not sufficient for the sale of the investment part of the product, as they do not include investment knowledge; they are not at equal level as those of the sellers of investment products.

As a result, the following is to be mentioned: professional requirements should be introduced for the persons selling investment policies (unit-links) and contacting the prospective applicant of insurance or providing update services to existing policyholders, irrespective whether these persons act as personnel of the insurance undertaking or as insurance intermediaries. Similarly, additional disclosure requirements should be introduced. The existing requirements on EU level for the sale of non investment insurance policies do not suffice. However, these additional requirements should not necessarily extend to the same level of the requirements provided for the seller of purely investment products. The simulation of the requirements for investment policies with investment products, as is proposed by EU consultation documents, would be an unbalanced burden for the insurance intermediaries.

3. INVESTMENT POLICIES DISTRIBUTED BY INSURANCE UNDERTAKINGS, INSURANCE INTERMEDIARIES, BANKS & OTHER INVESTMENT PROVIDERS

There is no need for the distributor to be qualified as an insurance intermediary if he sells investment policies which do not entail any transfer of risk at all. In such a case, the qualification as a distributor of investment products and thus the application of the existing professional and disclosure requirements imposed to investment firms suffices, although such products are still classified as insurance products, and more precisely as investment packaged insurance policies (investment policies).

On EU level the classification of the activities related to the above kind of investment policies as insurances is exclusively due to the fact that those are performed by an insurance company. However, purely investment policies without any risk element are not sold by investment brokerage firms or other investment firms, and are still exclusively sold by insurance undertakings. This is, of course, a formality which can act to the detriment of the consumer, as such a policyholder cannot enjoy the experience and the professional skills...
of the investment company and of its employee who contacts the clients. This is because although the policyholder receives investment services, nevertheless no special professional and disclosure requirements for the sale of investment services exist in the insurance sector (companies, insurance undertakings, intermediaries, employees who contact clients). Furthermore, the simple consumer can be easily confused because he is buying investment products which are named (packaged as) insurance, and therefore he may be under the wrong impression that he is protected as if he were an insured. This happens particularly in cases where the pure investment policy and its terms and conditions provide some unnecessary obligations to the insurance undertaking towards the policyholder, which are meaningless for policies without the risk element.

On the other hand, if the consumer receives life policies presented as financial products via a bank acting as (a tied) insurance intermediary, he is again confused as quite often he is under the impression that he buys investments - while at the same time the bank employee who sells the product may not be experienced enough and may not have the required knowledge for the sale of risk products. Moreover, the bank employee who serves among others, to sell investments and not insurances, is concentrated on the investment characteristic of the life policy - during the process of presenting and selling the policyholder and, in doing so, he fails to warn the consumer of the disadvantages of the product which arise out of its insurance element. The consumer is advised on the privilege of the guarantee (technical) interest which he enjoys via the financial products he is buying (i.e. the life insurance) and on its participation on the possible profits of the investment, without realising the disadvantages of the product being a life insurance due to the lack of proper advice on it (e.g. sometimes he cannot repurchase it before the lapse of some years, usually three, and even if he repurchases it right after the lapse of this period he will still have a financial loss in relation to the value concerned). Furthermore, the consumer is often not adequately informed and therefore does not realise the role of the bank acting only as intermediary and the fact that the entity whereby he entrusts the premium he pays is an insurance company. For this reason, additional warning, especially when such policies are sold by banks, is needed.

In both cases specific warning obligations and additional professional and disclosure requirements should be introduced to the insurance undertakings, insurance intermediaries, banks and other investment providers/distributors who sell insurance policies with investment character, in order to achieve more transparency and to avoid confusion.

As a result of the above, it follows that in the case where the investment policy includes a transfer of risk, banks and other investment providers/distributors have to be qualified as insurance intermediaries. Not least, their employees and directors who are being involved in the provision of such investment oriented services also need to be qualified as professionals bearing the specific knowledge required for the sale of insurance, in addition to their specific knowledge required for the sale of investment products.

4. INTERIM RESULT/GENERAL REMARK

Based on the principle of “real” consumer protection, the EU legislator is in the process of proceeding more and more towards the establishment of direct control with regard to disclosure and professional qualification requirements. The direct control requirement consists of rules for the improvement of the consumer protection, imposed not only to entities which conduct the insurance distribution but also to the natural persons who contact the clients, irrespectively whether those persons are employees of insurance intermediary undertakings or insurance undertakings. We face a tendency on EU level, and not only, which relocates the law from the insurance intermediation to the law governing the requirements of the natural persons pursuing the services in both direct and indirect retail sales.

Firstly, it is needed to understand better the kind and way that insurance undertakings sell investment policies and to clearly designate the borderline, if any, between those policies and the products of investment firms. Examples which illustrate the existence of a borderline, based on material differences between the investment policies and the other investment products, could be the following: in unit linked insurances the underlying assets are owned by the insurance undertakings. This is not the case with the UCITS Management Companies. The policyholder of unit-linked insurance has no choice as to the selection of the underlying assets while the receiver of investment products has this
option in a number of cases. In spite of those differences, efforts should indeed be further made in order for the rules to meet basic common principles in relation to both kinds of products.

Investment policies include more and more common characteristics compared with the other so called “packaged retail investment products” - PRIPs, so that on EU level it is suggested that all of them should be governed by standard requirements. As regards the retail investment policies, the ongoing improvement of both the insured’s protection and of the standardization as PRIPs, create the core of the modern rules for the distribution of the retail investment policies.

5. POLICIES LINKED WITH INVESTMENT AS PART OF THE PACKAGED RETAIL INVESTMENT PRODUCTS (PRIPS)

There is no legal definition of the packaged retail investment products (PRIPs). On EU level there is an ongoing discussion as to how the better protection of the consumer who buys packaged retail investment products will be achieved. The elements of the PRIPs have been identified as follows:

i. PRIPs offer exposure to underlying assets but in packaged forms, i.e. pre-drafted terms not subject to negotiation, in other words as investment products of the format “take it or leave it”;

ii. they primarily aim at capital accumulation;

iii. they have a mid- to long-term investment horizon;

iv. they are marketed to retail investors.

Their major element is that they constitute investment products marketed to retail investors. On EU level only the following forms of investment products are characterized as PRIPs: investment funds, insurance-based investment products (“unit-linked”), structured term deposits and retail structured securities.

The legal treatment of PRIPs as regards the pre-contractual information includes the application of the so called “Key Investor Information Document” (KID) for Undertakings for Collective Investment in Transferable Securities (UCITS) products, configured as a combination of principles and customized obligations. Lastly, existing sale practices include the application of all standards required for the providers of financial instruments.

6. CONCLUSION

European wide, and not only, there is an increased concern as regards the proper information on the product to be given to the consumer policyholders. The increasing complexity of the insurance products requires increasing information duties and the common task is to find the proper balance i.e. the optimum quantity and quality of information as well as the most efficient and balanced sanctions for the breach of this obligation. However it is generally accepted that sanctions do not suffice for the protection of the insured; in order to have an efficient protection established it is necessary also to set the prerequisite of the provision of professional requirements also of the natural persons who contact consumers during the process of sale and who promote insurance products. In order to achieve this goal the requirements cannot anymore be restricted to natural persons who work for the traditional insurance intermediaries undertakings but also they have to be extended to the natural persons who work for tied intermediaries i.e. for business units whose main business activity is not that of an insurance intermediary, in particular banks and further to the natural persons who work for insurance undertakings in order to cover the cases of direct sale.

New concerns arise in relation to investment policies to the extent that such policies combine insurance coverage and investments. The reason for those concerns is that professional and disclosure requirements are different as to the insurance coverage, whereas investment policies are usually treated as insurance policies. It follows from the above that, at EU level, there is lack of special, additional to the non-investment policies, professional and disclosure requirements which should be deemed as necessary for the protection of the consumer who buys investments packaged as policies. At a national level, different approaches are noted to exist as to the necessary additional information duties imposed to insurance intermediaries who sale investment policies. This again leads to a distortion of competition within the EU. It is arguable that at EU level this is a phenomenon arising out from the strict distinctions that the EU legislator has enacted via the imposition of the various regulations in the different financial sectors (in our case investment sector and insurance sector).