MFSA MALTA FINANCIAL SERVICES AUTHORITY

Feedback Document

Feedback Statement Issued Further to Industry Responses to MFSA Consultation Document on the Proposed Amendments to Chapter 4 of Part A of the Insurance Distribution Rules

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1.0 Introduction

On 23 April 2021, the MFSA issued a Consultation Document on the amendments to Chapter 4 of Part A of the Insurance Distribution Rules on Own Funds of Persons Enrolled in the Agents List, Managers List or Brokers List carrying out Insurance Distribution Activities and Reinsurance Distribution Activities. The purpose of this Consultation Document was to highlight the changes proposed to be carried out to Chapter 4 and Chapter 10 of the Insurance Distribution Rules and the Conduct of Business Rulebook.

The Consultation Document mainly focused on the concept of credit risk transfer, where an insurance undertaking may enter into an agreement with an insurance intermediary and the said undertaking assumes all the credit risk emanating from premia payment, in line with Article 10(6)(a) of Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (the "IDD"). The said Consultation also proposed amendments to the First Schedule of Chapter 10 of the Insurance Distribution Rules. Furthermore, new amendments on the own fund requirements of a cell of a cell company which is enrolled in the Managers List or Brokers List were also proposed. Finally, the Consultation Document also proposed amendments to the Conduct of Business Rulebook.

Further to the said Consultation Document, the MFSA is issuing a Feedback Statement on the comments received in relation to such consultation. An outline of the main comments received and the MFSA's position in relation thereto is provided below.

2.0 Main Comments Received on the Proposed Amendments to Chapter 4 of Part A of the Insurance Distribution Rules

2.1 Credit Risk Transfer Agreement

2.1.1 Industry Comment: Market participants expressed their concern with the MFSA's comments on the potential impairment of the insurance broker's independence and the possible conflicts of interest on the part of the insurance broker through the proposed extension of Article 10(6)(a) of the IDD. Market participants held that the role of the insurance broker is to safeguard the interests of their clients by offering them the most suitable insurance cover in line with their demands and needs, which is why the Credit Risk Transfer agreement would offer enough security in respect of insurance premiums paid to the insurance brokers and would thus not impair such broker's independence and give rise to conflicts of interest.

MFSA's Position: Primarily, the MFSA would like to refer to the Schedule to the Insurance Distribution Act, which identifies the insurance distribution activities and reinsurance distribution activities of insurance brokers. In line with the said Schedule, insurance brokers must act with complete freedom as to their choice of lawful insurers when bringing together, persons seeking insurance or reinsurance and insurers or reinsurers. The MFSA remains of the view that where an insurance broker enters into such an agreement, this may potentially impair the insurance broker's independence to act with complete freedom. Therefore, as a result, the MFSA is of the view that the new requirements will limit the possibility of impairment of the insurance broker's independence and the possible rise to conflicts of interest on the part of the insurance broker's relationship with one particular insurer through a credit transfer agreement. The MFSA would like to reiterate that the disclosure requirements identified in the Consultation Document aim to ensure complete transparency whilst carrying on insurance distribution activities and reinsurance distribution activities.

2.1.2 Industry Comment: A participant claimed that the requirement imposed on insurance brokers to provide the MFSA with a declaration from its compliance officer declaring that the current spread of business is "evenly" spread out should be removed. This is due to the fact that the business may not necessarily be "evenly" spread out and it may not necessarily be possible to maintain that position moving forward, in particular due to the nature of the business of the insurance broker.

MFSA's Position: In this respect, the MFSA would like to clarify that reference to the word 'evenly' should be taken to mean that in the absence of justifiable reasons, an insurance broker should not be relying on one particular insurer for any particular class of insurance it is distributing.

2.1.3 Industry Comment: A market participant pointed out that the credit risk transfer mechanism typically applies not only to premiums received by an intermediary from its insurance clients but also captures all forms of clients' monies received by the intermediary from both the insurer and the client, such as claims money and premium refunds or return premium. In this respect, it was suggested that the intention for such an arrangement to encompass all monies received by the intermediary is to be clarified through the inclusion of definitions in Chapter 4 and the Conduct of Business Rulebook on 'credit risk transfer agreement', 'monies' or 'client monies'.

MFSA's Position: Paragraph 5 of the Second Schedule to Chapter 4 indicates the contents of the Credit Risk Transfer Agreement. Sub-paragraph (d) of paragraph 5 refers to the word "monies". In this respect, the MFSA would like to clarify that the word "monies" indicated in the said Schedule and in Chapter 4 of the Insurance Distribution Rules includes all the monies received by an enrolled person in relation to an insurer with whom the enrolled person has entered into a credit risk transfer agreement, including but not limited to clients' monies received by the insurance intermediary from both the insurer and the client, such as claims money and premium refunds or return premium.

2.1.4 Industry Comment: A market participant stated that monies received by an intermediary under a Credit Risk Transfer arrangement are held as agent for the insurer and are therefore not in a fiduciary capacity. In this regard, the same participant asked whether such monies should be deposited in the Business of Insurance Intermediaries account.

MFSA's Position: The MFSA would like to clarify that all monies which an enrolled person receives in relation to an insurer with whom the person has entered into a credit risk transfer agreement with, is to be deposited in the Business of Insurance Intermediaries account. The monies may include but are not limited to clients' monies received by the intermediary from both the insurer and the client, such as claims money and premium refunds or return premium.

2.1.5 Industry Comment: A respondent requested clarification as to whether clients' monies received under a Credit Risk Transfer agreement should be comingled with or segregated from clients' monies received by the intermediary from insurers without such an agreement.

MFSA's Positi*on:* The MFSA would like to clarify that as long as the enrolled person retains proper internal records to identify which premiums are received in relation to which insurer, it is not necessary for clients' monies received to be segregated in different Business of Insurance Intermediaries accounts to ensure compliance with the own funds requirement under Chapter 4 of the Insurance Distribution Rules.

2.1.6 Industry Comment: Market participants also voiced their concern on the period for notification of the signing of a Credit Risk Transfer agreement to the MFSA, being 10 working days prior to entering into such an agreement. In this respect, such market participants recommended that notification to the MFSA should take place after the signature of a Credit Risk Transfer agreement, followed by acknowledgement on the part

of the same Authority. The same market participant also suggested that the Authority should indicate a standard wording which would be in line with the applicable regulatory requirements to avoid notifying the Authority.

MFSA's Position: The MFSA is of the view that the 10-working-day notification requirement that needs to be satisfied prior to the signing of a Credit Risk Transfer agreement is a reasonable time period. Furthermore, the MFSA would like to clarify that the requirement to inform the MFSA is only required at the time when the enrolled person enters into such an agreement with the insurer. Thus, the MFSA does not need to be informed every time such an enrolled person makes use of this facility. Finally, with respect, to the comment requesting standard wording to be drafted which would be in line with the applicable regulatory requirements, the MFSA is of the view that paragraph 5 of the Second Schedule provides enough clarity as to the requirements that need to be fulfilled when entering into a Credit Risk Transfer agreement.

2.1.7 Industry Comment: A market participant pointed out that, currently, Terms of Business Agreements entered into between insurers and insurance brokers already cater for credit arrangement and responsibility of premium. In this respect, they requested clarification as to whether such Terms of Business Agreements will be affected by the proposed rules.

MFSA's Position: The MFSA would like to clarify that insurers and insurance brokers that have already entered into a Terms of Business Agreement are expected to be in line with the requirements identified in the Second Schedule to Chapter 4 of the Insurance Distribution Rules within 6 months of the coming into force of the amendments to Chapter 4 or upon the renewal of the Terms of Business Agreement (where this applies), whichever comes first.

2.1.8 Industry Comment: A respondent put forward the suggestion that the 4% of written premium solvency requirement is to be abolished for local intermediaries unless the broker fails the Net Insurance Asset Test, wherein the Customers Balance and the Fiduciary Bank Account Balance are to exceed the Underwriters Balance.

MFSA's Position: In accordance with Article 10(6)(b) of the IDD "*Member States shall take all necessary measures to protect customers against the inability of the insurance, reinsurance or ancillary insurance intermediary to transfer the premium to the insurance undertaking or to transfer the amount of claim or return premium to the insured*". One of the possible measures to protect customers indicated in the said Directive is the imposition of "*a requirement for the intermediary to have financial capacity amounting, on a permanent basis, to 4 % of the sum of annual premiums received, subject to a minimum of EUR 18 750*". The MFSA remains of the view that such a requirement is an added protection against the inability of an enrolled person to transfer the premium to the insurance undertaking, and as such will not be amending this requirement.

2.2 Amendments to the Conduct of Business Rulebook

2.2.1 Industry Comment: A market participant opined that there is no need to inform customers that an insurance broker holds a credit risk transfer agreement prior to the completion of the insurance contract, as insurance brokers obtain alternative quotations from other insurers with whom no risk transfer arrangements are in place, and it is ultimately the client's decision where the insurance policy is placed. The same participant added that such an agreement does not affect the client but, if anything, gives the contract more certainty.

MFSA's Position: In the proposed amendment to the Conduct of Business Rulebook, the MFSA proposed a disclosure requirement on the Regulated Person to disclose to its clients the fact that it

has entered into a Credit Risk Transfer agreement with any one or more insurance undertaking whose products it also distributes. The MFSA would like to clarify that such disclosure should be provided at the stage where the insurance broker presents the different alternative quotes to the policyholder. This will ensure that the insurance broker can assist the policyholder to identify the policy which best fits his/her clients' demands and needs whilst at the same time ensuring compliance with the requirements to inform clients that it has entered into a Credit Risk Transfer Agreement. In this respect the relevant requirements are being introduced in the Rulebook by means of a new Rule R.1.5.19. It has also been clarified that for the purposes of this Rule, a 'credit transfer agreement' is the agreement as referred in the context of the Second Schedule to Chapter 4 of Part A of the Insurance Distribution Rules.

2.3 Cell Share Capital / Own Funds Requirement

2.3.1 Industry Comment: Concern was raised by a market participant on the rationale behind the imposition of the own funds requirement on individual cells of Protected Cell Companies (PCCs), as it may have a negative impact on the attractiveness of the use of such structures locally, without any perceived benefits which may accrue as a result of such imposition. The same market participant added that subjecting individual cells to minimum capital requirements would add on to the administrative burdens of the PCCs, especially where such PCCs have a large number of individual cells. Moreover, it was also mentioned that, even in the insurance sector, individual cells are not expected to maintain minimum capital requirements, seeing as they are not single legal entities. In this respect, a market participant expressed the view that the own fund requirements should apply to the PCC as a whole rather than to individual cells.

MFSA's Position: The MFSA's rationale behind the imposition of the own funds requirement on individual cells of Protected Cell Companies is based on the fact that the MFSA requires a level of commitment by market participants when setting up a Cell in a Protected Cell Company particularly now that Credit Risk Transfer Agreements can also be entered into by a Cell in a Protected Cell Company.

2.3.2 Industry Comment: Market participants also raised concern with regard to the proposed cell share capital that each cell of PCCs must have, which must not be less than €58,250. In this respect, one of the market participants put forward the suggestion that, the own funds requirements should be lowered to €15,000 minimum share capital per cell, reason being that cells could be used for smaller entities and thus cost/share capital factors into the equation in a decision to use Malta as a domicile. In this regard, reference was also made to the fact that Malta has the highest requirements in the EU when compared to capital requirements in other EU States and that most EU States do not even need capital. Another market participant also made reference to the Schedule to Chapter 4 of the Insurance Distribution Rules, which sets out two different own fund amounts (€16,803 and €58,250), in stating that, if such newly proposed own fund requirement is to be imposed, then in the case of insurance managers it should be consistent with the current rules that are in place as set out in the said Schedule.

MFSA's Position: Following further analysis carried out by the MFSA, taking into consideration the market feedback, the MFSA has decided to amend the own fund requirement of cells of a cell company from €58,250 to the amount of €19,510. This requirement is in line with Article 10(6)(b) of the IDD which requires a minimum financial capacity of €19,510. Moreover, in light of this new amendment, a transitional period of 6 months from the date when the amendments to Chapter 4 have been published will be applicable to allow enough time for individual cells of Protected Cell Companies to comply with the new own funds requirement.

2.4 Definition of 'Insurance Undertaking'

2.4.1 Industry Comment: Market participants raised their concern with regard to the definition of 'insurance undertaking', which includes an undertaking authorised under the Insurance Business Act or Directive 2009/138/EC (Solvency II Directive) to carry on business of insurance. In this respect, one of the market participants requested clarification on whether the said definition relates to insurance undertakings that are authorised in Malta only. Moreover, another market participant held that the application of such a definition should be extended also to apply to third country insurers who carry on business with a Maltese insurance intermediary in respect of risks not situated in Malta or where Malta is not the country of commitment.

MFSA's Position: The MFSA would like to clarify that the definition of 'insurance undertaking' relates to undertakings authorised under the Insurance Business Act and also other insurance undertakings authorised in other Member States in line with Directive 2009/138/EC and operating in Malta via freedom of services or freedom of establishment. With regard to the suggestion that the definition should be extended also to apply to third country insurers who carry on business with a Maltese insurance intermediary in respect of risks not situated in Malta or where Malta is not the country of commitment, the MFSA would like to clarify that in view of the fact that the IDD does not apply to third country insurers the definition will not be extended to include third country insurers.

3.0 Way Forward

A Circular informing market participants on the date of applicability of the amendments identified in the Consultation document will be issued together with this Feedback Statement. Following the Circular, insurers and insurance brokers which have already entered into a Terms of Business Agreement are required to amend the said Agreement in line with the requirements identified in the Second Schedule to Chapter 4 within six (6) months from the day the amendments to Chapter 4 come into force or on termination of the said Terms of Business Agreement, whichever comes first. Furthermore, cells of a cell company are also required to ensure that their own funds requirement is in line with the new requirements within six (6) months from the day the amendments to Chapter 4 come into force.

4.0 Contacts

Any queries or requests for clarifications in respect of the above should be addressed by email on ips_legal@mfsa.mt.