

05 October 2022

**The Board of Directors
The Compliance Officer**

Dear Sirs,

Re: IDD Suitability Requirements – Implications on Insurance Undertakings and Insurance Intermediaries’ existing Procedural and Organisational arrangements relating to the client suitability Assessment processes in the context of advisory sales of IBIPs following the new requirements incorporating sustainability preferences.

This letter is addressed to insurance undertakings and insurance intermediaries which distribute insurance-based investment products (“IBIPs”) on an advisory basis in terms of Article 30 of the Insurance Distribution Directive (the “IDD”).

Insurance Undertakings which distribute IBIPs through their Tied Insurance Intermediaries network and whose TIIs distribute such products on an advisory basis are responsible to bring the above to the attention of the relevant TIIs, including those which are also licensed to provide investment advice under the Investment Services Act.

Background

The suitability requirements are an essential element to ensure consumer protection within the distribution of insurance-based investment products (“IBIPs”).

As outlined in [MFSA Circular of 29 July 2022](#), the [Commission Delegated Regulation \(EU\) 2021/1257](#) of 21 April 2021 amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the integration of sustainability factors, risks and preferences into the product oversight and governance requirements for insurance undertakings and insurance distributors and into the rules on conduct of business and investment advice for IBIPs, has been applicable as from **2 August 2022**. These new IDD requirements on suitability have been implemented in MFSA’s Conduct of Business Rulebook.

By virtue of the amendments brought by means of the said Commission Delegated Regulation (EU) 2021/1257, the sustainability preferences of the individual client are required to be taken into account in the suitability assessments. The said Delegated Regulation has subsequently triggered the drafting of *new EIOPA Guidelines on the Integration of Customer Sustainability Preferences in the Suitability Assessment under the*

IDD. On 18 April 2022, the MFSa issued a [Circular](#) on EIOPA's Consultation in respect of such draft EIOPA Guidelines. The purpose of these draft Guidelines was to provide further guidance, amongst other matters, with respect to the following:

- (a) the collection of information on sustainability preferences from clients (to be collected as part of information on the investment objectives);
- (b) matching client preferences with products, based on the product disclosures under the Sustainable Finance Disclosure Regulation (EU) 2019/2088 (the "SFDR").

However, as outlined in [MFSa Circular of 25 July 2022, further to the Consultation referred above, on 20 July 2022 EIOPA published the following:](#)

- (a) [Feedback Statement](#) to the Consultation related to draft Guidelines on suitability assessment whereby EIOPA advised that, due to feedback received it paused its work on issuing Guidelines on the topic of sustainability preferences under Article 16 of Regulation (EU) No 1094/2010 (as initially proposed), in order to gather more information based on the implementation experience with the new legislative framework in the coming months. However, in the meantime EIOPA decided to focus instead on providing practical guidance in the form of a more simple and user-friendly document, as referred to in paragraph (b) below;
- (b) [Guidance on the integration of customer's sustainability preferences in the suitability assessment under IDD](#) (hereinafter referred to as "Guidance") in order to facilitate the sales process for sustainable products, as well as facilitate comprehension of how to integrate the client's sustainability preferences into the suitability assessment under the IDD. This guidance is non binding and should not be considered as EIOPA Guidelines. Therefore, the aim of the said Guidance is to promote a better understanding and facilitate a correct implementation of the new rules pursuant to Commission Delegated Regulation (EU) 2021/1257 which came into effect on 2 August 2022.

Insurance undertakings and intermediaries distributing IBIPs on an advisory basis are to recommend IBIPs that meet the sustainability preferences of their clients, if they have such preferences, so that as part of the suitability assessment, recommendations made to clients need to reflect both the financial objectives and any sustainability preferences expressed by those clients. The main amendments introduced by the Commission Delegated Regulation (EU) 2021/1257 and reflected in the Guidance are:

- (a) [Information to clients about the purpose of the suitability assessment, including the sustainability preferences](#) – Insurance undertakings and intermediaries need to help clients understand the concept of "sustainability preferences" and the choices to be made in this context. In this respect they need to also explain the difference between the different elements mentioned in the definition of "sustainability preferences" under paragraphs (a) to (c) thereof; as well as explain to clients the different aspects in a language that is clear, succinct, comprehensible and not misleading;

- (b) Collection of information from clients on sustainability preferences – Insurance undertakings and intermediaries need to collect information from clients on their preferences in relation to the sustainable investments underlying the IBIPs. This information should include all aspects mentioned in the definition of “sustainability preferences”;
- (c) Periodic Assessment of sustainability preferences – Insurance undertakings and intermediaries shall have processes as to how to match client sustainability preferences with products, based on product disclosures under the SFDR. If they do not have any IBIPs which meet the client’s sustainability preferences, they should not recommend IBIPs as meeting such preferences, unless the client adapts his/her preferences;
- (d) Arrangements necessary for insurance undertakings and intermediaries to understand the Sustainability features of IBIPs – including the arrangements necessary to ensure the suitability of an IBIP, also considering the sustainability factors of an IBIP in view of the subsequent matching with the client’s sustainability preferences;
- (e) Organisational requirements – Insurance undertakings and intermediaries need to give staff appropriate sustainable finance related training and ensure that staff possess the necessary knowledge and competence with regard to the criteria of the sustainability preferences.

Insurance undertakings and intermediaries shall also keep appropriate records of all relevant information about the suitability assessment and the sustainability preferences of the client (if any) and of any adaptation of these preferences (including a clear explanation of the reasons for such adaptation).

I. Compliance by Insurance Undertakings and Intermediaries and MFSA Expectations

Kindly note that the MFSA has been communicating its expectations with respect to the SFDR legal framework as well as the amending Delegated Acts by means of various Circulars (in particular, in the [MFSA Report of 12 April 2022](#) on Operational and Compliance Readiness by Financial Market Participants and Financial Advisers) whereby it has been emphasised that entities were required to take the necessary steps to ensure compliance and enhance their operational preparedness in complying with *inter alia* the changes brought by means of Commission Delegated Regulation (EU) 2021/1257, by 2 August 2022.

Although as indicated above, the guidance issued by EIOPA is not binding and should not be considered as EIOPA Guidelines, the Authority expects that insurance undertakings and insurance intermediaries distributing IBIPs on an advisory basis update their respective policies taking into account the guidance provided by EIOPA.

MFSA would like to remind insurance undertakings and intermediaries that, pursuant to the requirements of the Commission Delegated Regulation (EU) 2021/1257 and with

the support of EIOPA Guidance Note referred to above, they need to, amongst other matters:

- (a) **incorporate the collection and analysis of the necessary information about the client's or potential client's ESG/sustainability preferences** within their suitability policies and procedures, as part of the client's suitability assessment. In this respect, this would include:

- (i) **integrate considerations of the client's individual sustainability preferences into the Insurance undertakings and intermediaries' client suitability assessments and product selection process.** This requires Insurance undertakings and intermediaries to update and/or review the suitability questionnaires and existing procedural and organisational arrangements to the new sustainability requirements, so that, in addition to the existing elements of the suitability assessment, the client is to be asked on whether it has sustainability preferences and if he/she has such preferences, on which sustainability aspects, and these preferences should be taken into account; The identification of the client's suitability preferences should be seen as a "top up" to the suitability assessment so that that insurance undertakings and intermediaries first identify a range of suitable products for the client (in accordance with the criteria of knowledge and experience, financial situation, and other investment objectives); and then proceed by identifying the products that fulfil the client's sustainability preferences.

- (ii) **updating and/or reviewing the process of collecting sustainability preferences from clients**

For the purpose of a suitability assessment, the information to be obtained should include all aspects of the client's sustainability preferences. In this respect it is important also to note that an insurance undertaking or intermediary cannot recommend a product that does not match the client's sustainability preferences, unless the client adapts his or her preferences.

It is important to note that insurance undertakings and intermediaries are to obtain information on sustainability preferences in the course of the collection of information on investment objectives and this may be collected as the last element within the collection of information on investment objectives. However, in the latter case, this should not prevent the client, at his/her own initiative, from bringing up their sustainability preferences in an earlier part of the information collection. The Guidance Note referred above includes a decision-tree to illustrate process leading to the collection of information;

- (iii) **ensuring adequate record-keeping.** EIOPA also clarified in its Feedback Statement that the information on sustainability preferences should be updated by insurance undertakings and intermediaries when the

information on the client is being updated or at the time of a regular periodic assessment.

For existing clients, for whom a suitability assessment has already been undertaken insurance undertakings and intermediaries need to identify the client's individual sustainability preferences at the next regular update of the existing suitability assessment.

- (b) **provide appropriate training.** The legal requirements in terms of Commission Delegated Regulation (EU) 2021/1257 have entered into force on 2 August 2022 and therefore, it is important that:
- (i) Employees of insurance undertakings and intermediaries selling IBIPs need to have basic knowledge and competences to know how to assess the client's sustainability preferences; and
 - (ii) Employees of insurers and insurance intermediaries selling IBIPs that *promote environmental or social characteristics or that have a sustainable investment objective* should have a more detailed knowledge and competence, in accordance with the nature of products they provide advice on.

II. Next Steps – Action Required

It is important to highlight that notwithstanding the fact that EIOPA paused its work on issuing EIOPA Guidelines and instead issued a non-binding Guidance document (as outlined above), insurance undertakings and intermediaries distributing IBIPs on an advisory basis are required to fully comply with the legal requirements as set out in Commission Delegated Regulation (EU) 2021/1257 as from 2 August 2022.

Therefore, if your company distributes IBIPs on an advisory basis, you are kindly requested to submit to the Authority relevant extracts of:

- (a) An explanation of the changes which were implemented in the Company' suitability policies and procedures (including the Client Fact Find template) following the referred Commission Delegated Regulation (EU) 2021/1257 with the support of the guidance issued by EIOPA whilst considering the Company's business model. You are expected to cross-refer the above explanation with the relevant new requirements;
- (b) The relevant section of your policies and procedures relating to the suitability assessment; with specific reference to the sustainability preferences as well as an explanation of the changes which were implemented in the Client Fact Find or any other documentation used by the insurance undertaking or intermediary to record the suitability assessment, following the referred Commission Delegated Regulation (EU) 2021/1257 with the support of the guidance issued by EIOPA;

- (c) The template questionnaire or other document which the insurance undertaking or intermediary uses for the purposes of the collection of information concerned on the client's suitability preferences, in so far as sustainability factors are, sufficiently demonstrating that these have been updated and/or reviewed to take into account and ensure compliance by your company with the above-mentioned requirements as supported by the EIOPA guidance, in particular in relation to the client sustainability preferences.

Insurance Undertakings whose TIIs also distribute IBIPs on an advisory basis are to liaise with these TIIs for them to submit the above information by the date below.

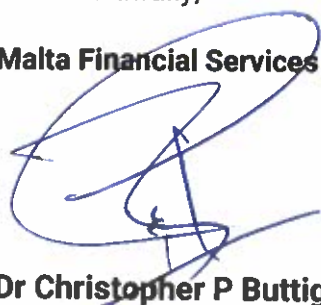
Kindly submit the above on csuinsurance@mfsa.mt by not later than 31st March 2023.

Furthermore, kindly note that the Authority will monitor the market to assess compliance with the applicable requirements and any future and we do not exclude that there may be future supervisory interactions in respect of the above.

Should you require any clarification on the above, please do not hesitate to contact Dr. Sarah Pulis Deputy Head Conduct Supervision (sarah.pulis@mfsa.mt), Mr. Stefano Lazze, Senior Technical Expert (Stefano.lazze@mfsa.mt) or Ms. Abigail Attard Technical Expert Conduct Supervision (Abigail.attard@mfsa.mt).

Yours faithfully,

Malta Financial Services Authority



Dr Christopher P Buttigieg
Chief Officer - Supervision

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