

Education: Insurance law course

Date: 2 May 2021

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Subject: The comprehensibility of the available product information for the customer in non-life insurance.

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2. Introduction

Problem Statement

Is the product still understandable and safe for the customer if a product developer complies with the legal requirements of title 7:17 BW for non-life insurance products, or does this conflict with Article 32 BGFO?

Because this essay focuses solely on non-life insurance, I will exclude products such as mortgages, investment insurance, and credit insurance from consideration.

Approach

This essay includes background information, literature review, and several legal comparisons and was developed in the following manner:

- Firstly, a literature review was conducted, and articles and books relevant to the topic were gathered;
- Subsequently, findings from this literature were incorporated into the text in the form of an introduction and substantive sections.
- Then, a practical case study is examined and evaluated against the legal framework.
- Finally, the conclusion presents my perspective on the discussed case with examples.

3. Scope of the Insurance Distribution Directive

The Insurance Distribution Directive (hereinafter: IDD) is a European directive. This directive establishes rules for the enforcement, application, and evaluation of arrangements concerning product oversight and governance for insurance products. Additionally, the directive includes standards for significant modifications to existing insurance products before those products are introduced to the market or distributed to customers. This latter process is called the product approval process. Furthermore, there are standards regarding product distribution for those insurance products. The IDD replaces the current Insurance Mediation Directive (IMD). Market participants were required to comply with this new regulation by October 1, 2018. This European directive has direct effect on national regulations. This means that national regulators must review the rules of this directive at the national level.

Purpose of IDD

The purpose of this directive is to create a level playing field within the European Union for all market participants offering insurance products. The directive promotes equal competition

conditions between market participants and an appropriate level of consumer protection. Additionally, the directive aims to harmonize sanctions for violations within the European Union.

Scope

This directive applies to insurance undertakings and insurance intermediaries who develop insurance products offered for sale to customers (hereinafter: product developers), as well as to insurance distributors who provide advice on insurance products not developed by themselves or propose them, such as advisers and intermediaries. Additionally, the IDD applies to companies selling insurance as an adjunct to a product or service (for example, car rental companies and travel agencies). The IDD clearly distinguishes between product developer and distributor. Despite various publications on this matter, there is often still confusion about when an insurer or distributor qualifies as a product developer, or when it does not. In this essay, product developers are understood to be insurers or intermediaries who develop, assemble, and make insurance available, and distributors are understood to be advisers and intermediaries. Direct providers are also distributors.

What product development standards apply to developers?

Product developers are providers, as well as intermediaries and appointed agents in certain situations. Such a situation arises, for example, when the intermediary or appointed agent plays a role in the decision-making process regarding the design or development of the insurance product. A role is assumed in any case when the intermediary or appointed agent autonomously determines significant characteristics or important components of the insurance product. The following rules apply to them:

- **Target Audience:** For each insurance, the target audience is determined including needs, characteristics, and objectives.
- **Product Testing:** Products are tested with relevant scenario analyses.
- **Product Evaluation:** Products are periodically evaluated.
- **Distribution:** The developer determines the appropriate distribution strategy for each insurance product. To ensure that the insurance product is distributed to the target audience, the developer must inform distributors about the product's characteristics, the product development process, the target audience, and the distribution strategy. This information enables the distributor to distribute the insurance product to the correct target audience.
- **Qualified Personnel:** The developer ensures that the personnel involved in product development have the necessary skills, knowledge, and expertise to understand the insurance product and the target audience.
- **Implementation:** The developer implements an adequate product development process.

What product development standards apply to distributors?

Distributors are intermediaries who advise or sell insurance products that they have not developed themselves. Direct providers are also distributors. The following rules apply to them:

- **Implementation:** The distributor establishes a product distribution process that ensures:
 - All necessary information from the developer is obtained so that the distributor understands the product's characteristics, the product approval process, and the target audience;
 - Damage to customers is limited or prevented;
 - Proper management of conflicts of interest is supported;
 - And the objectives, needs, and characteristics of the target audience are taken into account.
- **Alignment:** The distribution strategy and target audience are in line with those of the developer.
- **Evaluation:** The product distribution process is periodically evaluated, verifying whether insurance products are sold to the target audience.
- **Information Provision at the Request of the Developer:** Upon request from the developer, the distributor provides the developer with sales information about the insurance product and information about the outcomes of the periodic evaluation of the product distribution process as far as the developer needs it to evaluate the insurance product (e.g., information about sales outside the target audience, types of clients, and received complaints).
- **Proactive Information Provision:** If the distributor discovers that a product does not fit the identified target audience, they inform the developer and adjust their distribution strategy as necessary.

Who is not subject to IDD?

According to Article 25(4) of the IDD, the product and governance requirements do not apply to insurance products related to the insurance of large risks. These are, as defined in Article 2(16) of the IDD, large risks within the meaning of Article 13, point 27, of Directive 2009/138/EC.

4. Implementation of IDD in WFT

This chapter describes how the IDD has been implemented in our national regime, focusing on the aspects of product development and product information.

Product Development Process in WFT

The statutory application of the product development and approval process is set out in Article 32 BGFO. It is important to offer insurance products in the Netherlands that are of good quality, align with the Customer Interest Central (CIC), and meet market demand. A robust Product Approval and Review Process (PARP) forms the basis for relevant, high-quality products.

Article 32 of the Financial Supervision Act (BGFO) stipulates that a financial institution must have adequate procedures and measures in place to ensure that the development of a financial product takes into account the interests of the consumer, client, and, where applicable, the beneficiary of the financial product in a balanced manner. The financial product must demonstrably result from this balancing of interests. Additionally, further requirements are imposed on the aforementioned procedures and measures, the provision of product information to customers, and the evaluation of products.

The aforementioned decision aligns with the broader European regulations that impose product development requirements on financial products made available to a customer.

The following statutory requirements apply within the PARP Policy:

General product development process:

- Delegated Regulation (EU) 2017/2358 of 21 September 2017.

PARP Obligation:

- IDD DIRECTIVE ((EU) 2016/97 of 20 January 2016)
- Art 32 BGFO decision on the supervision of financial enterprises' behavior.

Generic PARP requirements:

- Del. Act EU 2017/2358
- EIOPA-BoS-19/172 dated 30 April 2019 (EIOPA's Technical Advice on the integration of sustainability risks and factors in the delegated acts under Solvency II and IDD).

Review obligation:

- IDD DIRECTIVE ((EU) 2016/97 of 20 January 2016)
- Del. Act EU 2017/2358.

Product testing (such as scenario analyses) and evaluation:

- Del. Act EU 2017/2358.

The AFM provides on its website a framework for processes and a framework for products, which have been published in the form of the so-called KNVB criteria. 22 The KNVB stands for cost-efficiency, usefulness, safety, and comprehensibility of financial products. Additionally, the AFM also imposes requirements on internal processes. As mentioned earlier, a European directive has a direct effect on this matter. 23

Recently, the AFM published its annual report for 2020²⁴, which revealed from the examination of auto and household insurance among six product developers (in this case, delegated agents, hereafter: DA), that five out of the six DAs did not have their product development and approval process in order. 25 In the spring of 2020, it also published a letter to the Dutch Association of Delegated Agents (NVGA) on its website regarding product development under the IDD. 26 The respective DAs have submitted an improvement plan to the AFM.

Product Information

Product developers must prepare a standard document for each product, the Insurance Product Information Document (IPID). 27 This document is similar to the former insurance card 28 and has a standard format. This IPID must be provided to the customer before concluding the insurance. 29 This can also be done electronically, provided that the customer explicitly gives prior consent and this document is available on a so-called "durable" medium 30.

Regarding information provision, the AFM stated the following in its annual report for 2020 31:

"Correct, clear, and non-misleading information provision. Supported by our data system, we continuously monitored advertisements for financial products and services. Based on this, we provided 18 feedbacks to market participants or foreign regulators. These feedbacks often led to adjustments in information provision. Additionally, we conducted a market-wide scan of information provision for insurance documents. We evaluated the insurance product information document (IPID) 32 of household, liability, and disability insurance policies. These often did not meet the standards. Based on this, we sent 17 feedbacks to market participants and published guidelines on the AFM website."

These guidelines help the product developer to create better and clearer IPIDs.

Product Information in Practice

In my work 33, I encounter a lot of product information such as terms, clauses, policies, IPIDs, and websites, which I assess against the KNVB criteria. 34 Always keeping the (end) customer in mind, not the intermediary or agent who can also be a customer. This end customer (often a consumer 35) must know what product they are getting, and products should meet what the customer can expect from that product (see also the aforementioned KNVB criteria). Through a number of example cases 36, I want to demonstrate that the provisions required for a product developer (in these cases "insurer") in its terms and conditions are sometimes not understandable to its customers.

Case: Text in additional terms and conditions that needs to be assessed against the KNVB criteria. While reading the terms and conditions of a business liability insurance (AVB), I come across the following text in the Additional Terms and Conditions Liability for Business Services:

This text is not clear in the context of the KNVB criterion of comprehensibility. "This condition, regardless of the product, is present in all (additional) terms and conditions. In other words, they are always the last ones to pay out." The comprehensibility of communication materials is assessed by insurers against a number of language levels. 37 This is called understandable language (B1), which represents simple Dutch. The most well-known term for this is "Jip and Janneke language". 38 Level B1 is used, among other places, on government websites and is much easier for the reader to understand than the language used in these insurance terms and conditions. 39 Most insurance terms and conditions do not meet this level. A characteristic of this language level is that the language used in the terms and conditions must be understandable to the target audience for whom the product is intended. 40

This immediately raises a number of questions. Does the legislator allow this at all? If this text appears everywhere in the additional terms and conditions at the product level, is it not a general condition? It always concerns the content of the clause/the condition.

Or is it a matter of a core term? A core term is a term that indicates the core of the performance;⁴⁴ without this term, an agreement could not be concluded at all. Of course, this is not the case here; you do not take out insurance with the idea that they will not pay out when necessary.

This scenario only arises when a problem arises regarding this condition and an actual disagreement arises between the respective contracting parties. The legal assessment will be discussed in the next section.

To answer these questions, I searched the website for the general terms and conditions. I found the following:

In the context of accessibility (again, clarity according to the KNVB criteria), the customer can only find the terms and conditions applicable to them based on their policy. For consumers, much has been stipulated about unfair terms in a directive for consumer contracts⁴⁵, but this does not explicitly apply to business customers.

However, under the IDD, a product developer is obliged to assess all financial products (both for individuals and businesses) offered against the target market. During the product approval process, the intended target market for each product is specified, ensuring that all relevant risks for such an intended target market are evaluated, that the planned distribution strategy is coherent with the intended target market, and reasonable steps are taken to ensure that the insurance product is distributed to the intended target market⁴⁶.

In addition to the target market, a more specific component is the target audience⁴⁷ of a product. The product developer generally publishes a target audience description on its website, making the target audience clear. It is also important to consider the non-target audience⁴⁸. In order to enhance consumer protection, especially concerning insurance-based investment products, product developers need to have the ability to distinguish a specific group of clients for whom the insurance product is generally not suitable. In this way, product developers can delineate groups of clients for whom the insurance product is typically not compatible with their needs, characteristics, and objectives.

It should be noted that by "business products" in this essay, large risks are not meant. These large risks⁴⁹ are considered bespoke and therefore do not need to comply with this European legislation as exceptions. The regulator expects product developers to assess the developed products against the described components for regular individual and business products.

The Na-u clause used by the sample insurer in its terms and conditions, I want to approach using Hendrikse's two-phase explanation model⁵⁰. This model can provide a solution when parts of the terms and conditions are unclear to the customer and a dispute arises. ⁵¹ By applying the explanation model to this case, the question can be answered whether the present insurance condition is clear, unclear, or incomprehensible.

The following questions need to be assessed:

- Is the condition clear? This question is answered affirmatively if only one interpretation is possible.
- Is the condition unclear? This is the case if two or more interpretations are possible.
- Is the condition incomprehensible? This is the case when it is completely unreadable.

A dispute resolver uses, among other things, the Haviltex criterion for this assessment, which means that when interpreting an agreement, not only the literal meaning of the text should be considered, but also the meaning that the parties could have attributed to that text, taking into account the circumstances of the case and based on what they could reasonably expect from each other.

Within Phase 1, there are several peculiarities that must be taken into account in the interpretation of the ambiguity or incomprehensibility of the relevant condition. The following special circumstances in Phase 1 of the interpretation model affect the outcome:

1. Expertise of the insured in a particular field;
2. Assistance of the insured by an independent intermediary;
3. Tailor-made coverage or standard coverage with deviating risk characteristics;
4. Industry or group practices;
5. A commercial agreement entered into by business parties with the assistance of legal advisors;
6. The insurance is a market policy;
7. The insurance terms and conditions were not negotiated;
8. Information on the insurer's website;
9. There is a coverage restriction or exclusion.

From Phase 1 perspective, several possible outcomes can follow:

1. The text is clear: then that interpretation is assumed, even if it is detrimental to the consumer.
2. The text is unclear or incomprehensible: then the second phase of the two-phase model can be applied.

Hendrikse sketches four possible scenarios here that should contribute to a clear outcome. The following variants are possible:

1. The clause is unclear, and the insurer and consumer are at odds;
2. The clause is unclear, and the insurer and non-consumer are at odds;
3. There is an incomprehensible clause, and the insurer and consumer are at odds;
4. There is an incomprehensible clause, and the insurer and non-consumer are at odds.

Suppose the insured has a dispute over the provision as described in this case.

When the text is assessed using the 2-phase model, from my perspective, the outcome of phase 1 is that the condition is not clear because it can be interpreted in different ways. Who pays out first? This insurer always pays out last. Does a consumer understand this?

If the consumer even reads the terms and conditions, by the way. Many consumers skip them because they often find them 'too difficult', so they often end up surprised when they claim their insurance. And when you explain this clause in "plain language," it could be a reason not to take out the insurance, as the consumer may assume that this insurer will never pay out.

Technically, the insured in this case could be a sole proprietor on a business liability insurance and therefore could be seen as a non-consumer. With business insurance, it often happens that a consumer (with a small business) takes out a business product. This means that the required knowledge is not always present to properly assess this insurance.

Because the customers of this insurer are always assisted by an independent intermediary, phase 2 applies as a special circumstance 2. Therefore, I will not consider phase 2 in this essay.

6. Final Conclusion

In the past, consumer trust in financial products has been significantly undermined. Due to the debt crisis and, more recently, the bankruptcy of Conservatrix, it is crucial to maintain customer trust. However, the way insurers have treated their customers, the products they have offered, and the costs charged for them have also damaged trust in the past.

Therefore, it is important for product developers to offer insurance products that are of good quality, align with customer interests, and meet market needs. A good Product Approval and Review Process (PARP), with European guidelines as an overarching element, is the basis for relevant, high-quality products.

If a random person is asked about the KNVB criteria, they will usually think of football. If the same person is asked about "plain language," the link with football is likely to be dropped because the person in question understands that this concerns simple language.

Product information developed and provided by product developers to consumers and non-consumers is not always understandable for the target audience. The specific requirements that a product developer wants to set out in its terms and conditions make the text virtually unreadable or incomprehensible for a layperson.

Consumers are protected by consumer law. Nevertheless, I see many inaccuracies in private and business terms and conditions in practice, whether the target audience is business or not, but where it cannot be expected that the customer has any insurance knowledge.

Certain parts of business terms and conditions simply cannot be described in understandable language. This is mainly about specific terms used in insurance terms and conditions or references to legal articles in insurance terms and conditions or additional clauses added to a policy that unfortunately do not fit the conditions as described in the product. Often, the legal and/or legal basis is at odds with the clarity expected from the KNVB criteria and the Insurance Distribution Directive.

If a dispute arises over a particular condition, the 2-phase interpretation model can provide a solution. This 2-phase model is more than just a legal assessment. It also looks at the special circumstances of the parties who have a dispute over a specific insurance condition.

In practice, the safety and clarity of conditions and the legal basis still diverge because multiple factors need to be added to the assessment of products against the KNVB criteria. Texts must be understandable for the average person, such as at B1 level. In general terms and conditions, this is often not possible due to the intention to legally secure general terms and conditions completely, where the use of certain terms or jargon is simply unavoidable.

However, there are insurers like Hema that have added an introductory document explaining the key elements of the insurance to the customer in understandable language. The IPID also helps the customer to better compare the products. The conditions themselves are understandable and readable but still at a B2 or C1 level, because insurance jargon, which sometimes includes non-legal terms, has acquired a legal connotation over the years.