

Applicability of the Insurance Distribution Directive to law firm activities

1. INTRODUCTION AND NEXT STEPS

- 1.1 Following the implementation of Directive (EU) 2016/97 (the "**Insurance Distribution Directive**" or "**IDD**") in the UK, including the updated SRA Financial Services (Scope) Rules, law firms have identified that in certain limited circumstances the advice given by such firms, in connection with insurance, reinsurance, life insurance contracts and liability risks insurance contracts may fall within the scope of the IDD. As a consequence, where the advice relates to a contract of insurance other than life insurance or liability risks insurance, a law firm will be regulated by the SRA. Where the advice relates to reinsurance, life insurance or liability risks insurance, the law firm may, on the face of the current reading of the IDD and the SRA Financial Services (Scope) Rules need to register with the FCA.
- 1.2 This paper has been prepared on behalf of the City of London Law Society Insurance Law Committee (the "**Committee**"), and sets out an analysis of the applicability of the relevant legislation to law firms in the context of the IDD and the applicable SRA rules. Following a number of conversations with the SRA and several law firms who practice regularly in the insurance field and for the reasons set out in further detail in the note below, it is the Committee's position that whilst technically an FCA registration may be required for certain law firms, this is not a satisfactory position.
- 1.3 The Committee therefore recommends that the SRA and the FCA amend their rules to (i) allow for the SRA to regulate all law firm in-scope (re)insurance distribution activities; and (ii) clarify any applicable regulatory requirements with respect to such activities.
- 1.4 The Committee recommends a conference call between the SRA, the FCA and relevant representatives of the Committee to consider and discuss this note and the appropriate next steps.

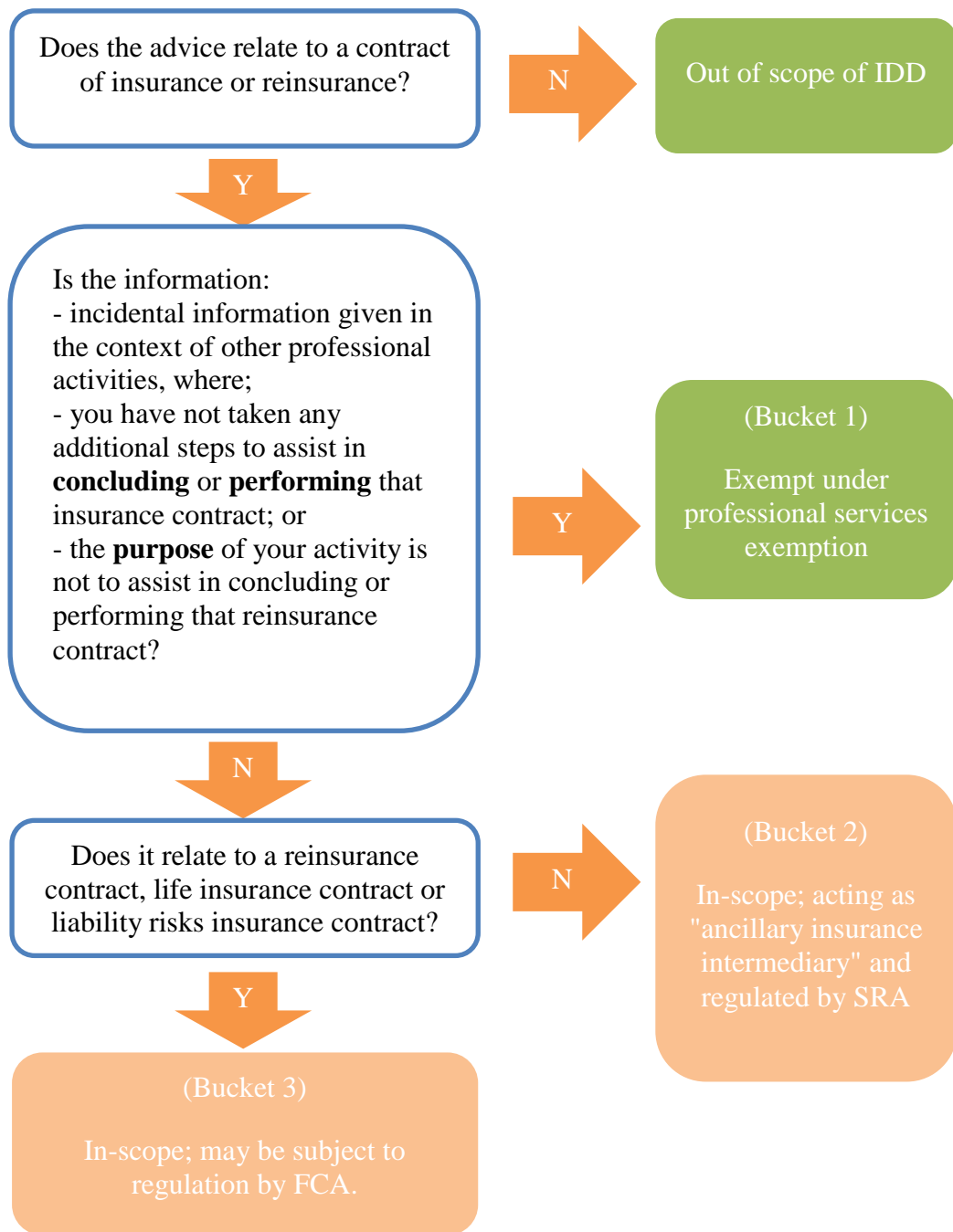
2. BACKGROUND

- 2.1 This note provides guidance on the scope of the IDD, which became effective on 1 October 2018, replacing the Insurance Mediation Directive ("**IMD**").
- 2.2 This note provides an analysis of the types of case where law firms may fall within the scope of the IDD. It also sets out the regulatory consequences of falling within the scope of the IDD.
- 2.3 We also note that the IDD is an EU directive which has been transposed into UK law. We understand steps are being taken at the moment to prepare for its onshoring following the end of the Brexit transition period on 31 December 2020. It will therefore be important to revisit and potentially update this advice once the text of the new legislation is available.

3. EXECUTIVE SUMMARY

- 3.1 In most cases where law firms are providing information in connection with insurance cover, it will be in the context of a wider mandate to provide legal advice. In most cases, this would fall within the IDD's professional services exemption and as a result would fall outside the scope of the IDD.
- 3.2 However, in certain cases, law firms may give advice which goes beyond the scope of the professional services exemption. This is where a law firm takes steps to, or with the intention of, assisting the client with concluding or performing an insurance contract (which could include for example, taking steps to help a client enter into the insurance contract such as drafting, negotiating, such that the client would not have entered into the contract if such steps had not been taken). Law firms do in certain cases give such advice in connection with insurance, reinsurance, life insurance contracts and liability risks insurance contracts. This advice would fall within the scope of the IDD.
- 3.3 The consequence of law firms falling within the scope of the IDD for these purposes is:
- 3.3.1 Where the advice relates to a contract of insurance (other than life insurance or liability risks insurance), a law firm will be an "ancillary insurance intermediary" for the purposes of the IDD. Ancillary insurance intermediaries are regulated by the SRA and the law firm would need to notify the SRA that it carries out these activities. The most common examples of Liability Risk Insurance are employer's liability, public liability, product liability, professional indemnity, contractor's liability, protection and indemnity, directors and officers, motor insurance, environmental liability and cyber liability. It would also need to appoint an Insurance Distribution Officer, ensure certain information is given to clients when carrying out the relevant work and may need to arrange relevant training for lawyers who undertake this work.
- 3.3.2 Where the advice relates to reinsurance, life insurance or liability risks insurance the law firm would fall outside the category of an "ancillary insurance intermediary" for the purposes of the IDD so may, on the face of it, need to register with the FCA. However, as discussed further in paragraph 7 below, the drafting of this section of the IDD is unclear, as is how such an FCA registration would work. This is a market wide industry-wide issue which has been raised by multiple City law firms, who may need to liaise with the SRA and FCA to understand the best way forward in connection with this subset of work.

3.4 The chart below summarises the position:



4. (RE)INSURANCE INTERMEDIATION ACTIVITIES UNDER THE IDD

What are (re)insurance intermediation activities under the IDD?

4.1 The IDD regulates persons who provide 'insurance or reinsurance distribution services to third parties'. For these purposes, the following definitions apply:

4.1.1 "**insurance distribution**" is defined as the activities of advising on, proposing, or carrying out other work preparatory to the conclusion of contracts of insurance, of concluding such contracts or of assisting in the administration and performance of such contracts, in particular in the event of a claim, including the provision of information concerning one or more insurance contracts in accordance with criteria selected by customers through a website or other media and the compilation of an insurance product ranking list, including price and product comparison, or a discount on the price of an insurance contract, when the customer is able to directly or indirectly conclude an insurance contract using a website or other media; and

4.1.2 "**reinsurance distribution**" is defined as the activities of advising on, proposing, or carrying out other work preparatory to the conclusion of contracts of reinsurance, of concluding such contracts or of assisting in the administration and performance of such contracts, in particular in the event of a claim, including when carried out by a reinsurance undertaking without the intervention of a reinsurance intermediary.

What exclusions may apply?

4.2 The following exclusions are potentially available to law firms under the IDD:

4.2.1 **Exclusion for providing information given in the course of other professional activities**

Providing information on insurance and insurance cover by professionals (including lawyers), where:

- (a) the provision of information is on an incidental basis in the context of their other professional activities; and
- (b) either:
 - (i) the professional does not take any additional steps to assist in concluding or performing an insurance contract; or
 - (ii) the purpose of that activity is not to assist the customer in concluding or performing a reinsurance contract.

4.2.2 **Exclusion for introducing activities**

'Mere introducing activities' consisting of the provision of data and information:

- (a) on potential policyholders to (re)insurance intermediaries or undertakings; or
- (b) about (re)insurance intermediaries or undertakings to potential policyholders.

4.3 Where a Law firm is providing information in connection with insurance cover in most cases will be in the context of a wider mandate to provide legal advice. This would fall within the professional services exclusion set out at 4.2.1 above, provided that (i) in relation to insurance contracts, no lawyer takes additional steps to, or with the intention of, assisting the client with concluding or performing an insurance contract; or (ii) in relation to reinsurance contracts, the purpose of the lawyers' activity is not to assist the customer in concluding or performing a reinsurance contract.

5. **FIRM ACTIVITIES THAT DO NOT FALL WITHIN SCOPE OF EXCLUSION**

5.1 We understand that firms do in certain cases, carry out activities that do not fall within the scope the professional services exclusion discussed above.

5.2 This is where the firm takes "additional steps to, or with the intention of, assisting the client with concluding or performing an insurance contract" or "the purpose of that activity is to assist the customer in concluding or performing a reinsurance contract".

5.3 "Additional steps to, or with the intention of, **concluding** an insurance contract" has been interpreted as meaning that the intermediary has taken steps to help the client enter into the insurance contract, such that the client would not have entered into the insurance contract if those steps had not been taken. In relation to reinsurance contracts, the relevant lawyers must consider whether or not the provision of their advice is for the "purpose of assisting the customer in concluding or performing a reinsurance contract". Where law firms are directly involved in the drafting and negotiation of the terms of a particular (re)insurance contract it will likely meet each of the relevant tests and thus fall within the scope of the IDD.

5.4 We also understand that law firms may take "additional steps to, or with the intention of, assisting the client with **performing** an insurance contract" where they provide advice to a policyholder on claiming under an insurance contract.

5.5 What is the consequence of law firms carrying out this work? They will not fall within the scope of the professional services exemption and as a result will come within the scope of the IDD. Accordingly, it will be carrying on (re)insurance distribution activities for the purposes of the IDD.

5.6 The IDD categorises persons carrying on (re)insurance distribution activities as one of the following:

5.6.1 "**insurance intermediary**" means any natural or legal person, other than an insurance or reinsurance undertaking or their employees and other than an ancillary insurance intermediary, who, for remuneration, takes up or pursues the activity of insurance distribution;

- 5.6.2 **"reinsurance intermediary"** means any natural or legal person, other than a reinsurance undertaking or its employees, who, for remuneration, takes up or pursues the activity of insurance distribution;
- 5.6.3 **"ancillary insurance intermediary"** means any natural or legal person, other than a credit institution or an investment firm as defined in points (1) and (2) of Article 4(I) of Regulation (EU) No. 575/2013 of the European Parliament and of the Council who, for remuneration, takes up or pursues the activity of insurance distribution on an ancillary basis, provided that all of the following conditions are met: (a) the principal professional activity of that natural or legal person is other than insurance distribution; (b) the natural or legal person only distributes certain insurance products that are complementary to a good or service; and (c) the insurance products concerned do not cover life assurance or liability risks, unless that cover complements the good or service which the intermediary provides as its principal professional activity.
- 5.7 Firms may meet the criteria for "ancillary insurance intermediary" with respect to its insurance distribution activities. For certain of its activities, therefore, law firms are an "ancillary insurance intermediary" ("**AII**"). It is noted that although law firms would receive remuneration for their legal services, being their principal professional activity, and may not be directly remunerated for any insurance distribution activities, it will be difficult to argue that law firms are not being remunerated for the identified insurance distribution activities, particularly as they will be remunerated for all of their services together and they would expect that the insurance distribution activities would fall within their business/activities.
- 5.8 However, the definition of AII does not cover advice in connection with reinsurance or life assurance or liability risks (which law firms in certain cases may advise on). There is therefore a third set of activities where law firms may fall within the scope of IDD but as an insurance intermediary or reinsurance intermediary, not as an AII.

6. **CONSEQUENCES OF BEING AN AII**

- 6.1 The FCA's conduct of business rules set out certain requirements applicable to AIIs. AIIs which are law firms are registered with and regulated by the SRA. The requirements that apply to AIIs which are law firms are, as a result, those set out by both the FCA and SRA.

SRA/FCA requirements on firms conducting insurance distribution as an AII

6.2 **SRA Requirements**

- 6.2.1 The SRA Financial Services (Scope) Rules require firms to comply with the following requirements in relation to conducting insurance distribution as an AII:
- (a) register in the Financial Services Register.;
 - (b) appoint an insurance distribution officer responsible for insurance distribution activities of the firm; and

- (c) notify the SRA of conducting insurance distribution as an AII in the following form: <https://www.sra.org.uk/solicitors/firm-based-authorisation/notify-financial-services/>.

6.2.2 Furthermore, the SRA Financial Services (Conduct of Business) Rules places firms under a number of obligations in relation to conducting insurance distribution as an AII. More information can be found [here](#).

7. CONSEQUENCES OF BEING A (RE)INSURANCE INTERMEDIARY FOR CATEGORIES NOT COVERED BY AII

7.1 As identified above, certain activities conducted by firms will fall within the definition of (re)insurance distribution. However, as currently drafted, in the event that firms are carrying on either (i) reinsurance distribution activities or (ii) insurance distribution activities relating to life or liability risks, such activities will not fall within the scope of activities that can be carried out by an AII. Accordingly, firms may require authorisation from the FCA in respect of these activities.

7.2 We note that there is some uncertainty as to how activities within this subset of activities should be regulated. The IDD is drafted primarily with retail insurance customers in mind, and does not appear to envisage the scenario where a law firm, advising on bespoke reinsurance contracts, life insurance and liability risks insurance contracts for sophisticated counterparties, would technically come within the scope of the IDD in respect of this advice.

7.3 Whilst technically an FCA registration would be required, we are not aware of any other law firm which is so registered.

7.4 The SRA have reached out to Clifford Chance LLP for (i) our view of the situation and (ii) to get a sense (via the insurance committee) as to whether other law firms are facing the same issue.

7.5 We understand that the SRA supports the carving-out of reinsurance activities, life insurance activities and liability risks insurance activities from its regulatory perimeter. However, in our view there is a good case to be made that this distinction does not make sense. In particular:

Distinction between "insurance distribution" and "reinsurance distribution"

7.5.1 The definitions in the IDD distinguish between reinsurance and insurance. However, in the UK, reinsurance has typically been considered to be a subset of insurance and references to "insurance" and have therefore been taken to include references to "reinsurance".

7.5.2 The drafting of the IDD distinguishes between "insurance distribution" and "reinsurance distribution" in the definitions, but then refers to "insurance distribution" only in the rest of the text, including in the sections which deal with all of the consequences of an activity being regulated. It seems strange that "reinsurance distribution" activities would be defined as in-scope, but then not subject to any regulatory requirements. It makes more sense if references to "insurance distribution" are read as including reinsurance as well, as then

the same regulatory requirements would apply. However, it is not clear whether the FCA agrees with this reading, although we note that the guidance in the FCA Handbook PERG 5.3.5G notes that:

"The *Regulated Activities Order* does not define a *reinsurance* contract. The essential elements of the common law description of a contract of *insurance* are also the essential elements of a *reinsurance* contract. Whilst the IDD addresses insurance and *reinsurance* separately, throughout the *guidance* the term 'contract of insurance' (italicised or otherwise) also applies to contracts of *reinsurance*."

- 7.5.3 For the kind of bespoke arrangements which certain firms may advise on, there is little meaningful difference between insurance and reinsurance contract. For example, firms may advise on an insurance policy as well as a back-to-back reinsurance policy which would deal with identical risks. In this way, it makes little sense for a law firm's role in respect of these activities to be regulated by two different regulators.

Insurance products concerning life assurance or liability risks

- 7.5.4 The definition of AII explicitly carves out activities relating to policies or products concerning life assurance or liability risks. This distinction may make sense in the context of retail insurance, which the IDD was clearly drafted to address due to the particular customer protection issues raised in the context of life insurance. However, when firms advise on bespoke insurance arrangements which relate to life insurance, it may often be in the context of large-scale risk transfer transactions between sophisticated counterparties and these customer protection issues would be unlikely to apply.
- 7.5.5 However, the definition states that such products cannot be covered unless the "cover complements the good or service which the intermediary provides as its principal professional activity". It may therefore be argued that the service of providing legal advice/conducting (re)insurance distribution is complementary to the broader service which firms provide i.e. legal advice.

Next steps

- 7.6 Clearly, it is not a satisfactory position that for law firms to require FCA registration in respect of their reinsurance, life insurance and liability risks insurance advisory activities. However, due to the uncertainty in the drafting of the IDD and legal position, as detailed above, it is not clear how this may be rectified.
- 7.7 The best result would be for the SRA and FCA to take a clear position on what regulatory requirements apply with respect to these activities. In our view, the best and simplest approach would be for the rules to be amended such that these activities are no longer carved out of the definition of an AII and accordingly law firms would be regulated by the SRA in respect of all of its in-scope (re)insurance distribution activities.