

REGULATION OF THE EU INSURANCE MARKET. IMPACT OF THE LAMFALUSSY STRUCTURE ON EU INSURANCE ACTS

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Abstract: *Financial services represent a highly regulated area under the law of the European Union. Insurance industry is not an exception. Day by day Member States, insurers and as a consequence consumers as well, have to deal with an avalanche of coming bylaws harmonising extensively fragmented market within Europe. The article focuses on the so-called Lamfalussy structure which was supposed to help with the adoption and implementation of the legislative bulk. Subsequent years following its development have shown that Lamfalussy structure has certain gaps and huge manoeuvre for improvement. Thus, the author refers to few particular problematic aspects thereof and tries to provide a reader with an insight how the intricate and fascinating EU (non)legislative process really works in practice. The recently adopted legislative acts in the field of insurance distribution and the pursuit of insurance business as such serve as good examples.*

Keywords: *EU, legislative process, Lamfalussy, insurance industry, distribution, PRIIPs, Solvency II*

INTRODUCTION

In recent years, a considerable number of EU acts dealing with insurance regulation and distribution issues have been adopted.¹ These acts are generally adopted under the veil of consumer protection. The process of passing EU legislation in the financial services area underwent significant changes due to the so-called Lamfalussy structure. What are the impacts of the Lamfalussy structure? Is this an appropriate time to review the process? What are the benefits of such regulation of the insurance market?

INTRODUCTION TO THE LAMFALUSSY STRUCTURE

Before evaluating the impact of current EU activities in the field of financial services, it is necessary to explain the specific aspects of adopting such acts for financial markets. In July 2000 the Economic and Financial Affairs Council (hereinafter “the Ecofin Council”) charged the so-called Committee of Wise Men chaired by Baron Alexander Lamfalussy, a former banker and economist, with the analysis of the best possible solutions for the implementation and transposition of measures of the financial services action plan with respect to the depth of the issues to be dealt with and the need to act quickly.² This four-

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¹ See for example Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II); Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution; Regulation (EU) No. 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

² Cf. SCHAUB, A. The Lamfalussy process four years on. *Journal of Financial Regulation and Compliance*. 2005, Vol. 13, No. 2, pp.110-120; DUNCAN, A. The Lamfalussy Process and EU Bank Regulation: Another Step on the Road to Pan-European Bank Regulation? *Annual Review of Banking & Finance Law*. 2006, Vol. 25, p. 389; POSNER, E. Financial Transformation in the European Union. In: MEUNIER, S., MACNAMARA, K. R. (eds.). *Making History: European Integration and Institutional Change at Fifty. The State of the European Union*. 2nd ed. Oxford: Oxford University Press, 2011, pp. 142–143.

level Lamfalussy structure³ represents the basis of the implementation process in financial services. The European Commission has the leading role in the legislative process, and this role is becoming an increasingly pressing issue.

In the first level, general legislative acts are adopted predominantly by the European Parliament and the Council.⁴ As these acts are usually very succinct and it is necessary to detail many provisions, an abundance of secondary legislation is adopted by the European Commission. In accordance with Articles 290 and 291 of the Treaty on the Functioning of the European Union (hereinafter the “TFEU”), they are acts adopted under the authority delegated to the European Commission, or implementing legislation in the form of regulations or directives. They are often drafted by European supervisory bodies, which for the insurance area is the European Insurance and Occupational Pensions Authority (EIOPA). The prominent features of the third and fourth levels are the role of the European supervisory bodies having the authority to issue their own guidance documents (sometimes called tertiary legislation), the need for effective cooperation among the Commission, European supervisory bodies and member states, and, last but not least, the supervisory power of the European Commission to ensure due implementation in member states.⁵

This at first glance sophisticated model unfortunately often results in an incoherent clutter of regulations that financial services providers must comply with.

THE FIRST AND THE SECOND LEVELS OF THE LAMFALUSSY STRUCTURE OR HOW NOT TO DROWN IN THE PROCESS OF ADOPTING EU FINANCIAL SERVICES RULES

As indicated above, the legislative process in the EU, including the implementation process in line with the Lamfalussy structure, is complex and not easy to understand for an ordinary user. And adoption of the legislative act is by far not the end of the process, but rather only the beginning. The addressees of the primary regulations must expect gradual adoption of other lower-level regulations, which considerably complicates the implementation procedure as many (and *de facto* important) elements⁶ are further detailed in these lower-level regulations. It is thus often impossible to begin with the implementation procedure before all the regulations of the second or even third level have been adopted – which often occurs shortly before the end of the transposition/implementation deadline.

³ LAMFALUSSY, A. et al. Final Report of the Committee of Wise Men on the Regulation of European Securities Markets. In: *European Commission* [online]. 15. 2. 2001. Available at: <http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-reportwise-men_en.pdf>.

⁴ The application of ordinary or special legislative procedure depends on the legal basis enshrined in the Treaty on the Functioning of the European Union.

⁵ LAMFALUSSY, A. et al. Final Report of the Committee of Wise Men on the Regulation of European Securities Markets. In: *European Commission* [online]. 15. 2. 2001. Available at: <http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-reportwise-men_en.pdf>.

⁶ In this context it is necessary to point out Article 290(1) of the TFEU, which states that “A legislative act may delegate to the Commission the power to adopt non-legislative acts of general application to supplement or amend certain non-essential elements of the legislative act.”

As an illustration, we can use the example of the process of adopting the secondary regulations related to Regulation (EU) No. 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) (hereinafter the “**PRIIPs Regulation**”).⁷

The PRIIPs Regulation was published in the Official Journal of the European Union on 29th December 2014 and entered into force on the twentieth day after its promulgation. With respect to the complexity of the matters regulated, the PRIIPs Regulation is not directly applicable as of the date it entered into force, which is the case for many EU regulations, but rather has a deferred applicability to 31st December 2016.⁸ Similarly to EU directives, a two-year implementation period is granted to the addressees in order to implement all the procedures and documents required by the regulation. As opposed to the directives, the regulation is not implemented through national legislation and therefore the member states are not required to adopt legal regulations to transpose the EU regulation. All affected persons must follow the regulation itself.⁹ As explained below, this two-year implementation period is in reality much shorter due to the need to adopt secondary regulations before implementation can occur.

The PRIIPs Regulation introduces unified rules for the form and content of the so-called “key information documents” and for the provision of such documents to retail investors with the aim of enabling them to understand the main features of products with an investment component and the related risks. One of the main reasons for adopting the PRIIPs Regulation was that retail investors are offered a broad range of structured products with an investment component (i.e., investment products and insurance products with an investment component) where the existing information on these products is not standardised and makes it difficult for retail investors to compare and understand these products.¹⁰ Investors therefore cannot make informed decisions about the investment.

One of the means of bridging the information gap was the creation of the “key information document” (hereinafter the “**KID**”). The objective of a KID is to facilitate consumers’ understanding and comparison of various investment products. The PRIIPs Regulation vested in the European Commission the power to adopt regulatory technical standards¹¹ (hereinafter the “**RTS**”) providing the details of presentation and content of information contained in the KID, methods supporting the presentation of risks and revenues in the KID, and methods for calculating the costs including specific overall indicators in the KID. The European supervisory authorities were charged with drafting the RTS.^{12, 13}

⁷ Official Journal L 352, 9.12.2014, pp. 1–23.

⁸ Cf. Article 34 of the PRIIPs Regulation.

⁹ This is why the term “implementation period”, which is more general, is used rather than “transposition period”.

¹⁰ Cf. point 1 of the preamble of PRIIPs Regulation.

¹¹ In accordance with Article 8(5) of the PRIIPs Regulation and Articles 10 to 14 of Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/79/EC, these RTS are adopted as delegated legislation.

¹² The European supervisory authorities include the European Banking Authority (“EBA”), European Securities and Markets Authority (“ESMA”), and the European Insurance and Occupational Pensions Authority (“EIOPA”).

¹³ See Article 8(5) of PRIIPs Regulation.

In accordance with the EU regulation establishing the EIOPA,¹⁴ the RTS are non-legislative acts of a technical nature and they do not represent strategic or political decisions. The content of the RTS must be in accordance with PRIIPs Regulation. After receiving the draft RTS, the European Commission has three months to approve them.¹⁵ The RTS generally take the form of a regulation or decision (in this case the form of regulation was chosen) and are adopted in the form of delegated acts under Article 290 of the TFEU. These so-called delegated acts are non-legislative public acts that supplement or amend some elements of the legislative act that are not so essential. The difference between EU legislative acts (e.g., PRIIPs Regulation) and non-legislative acts consists basically in that the legislative acts are adopted (usually) jointly by the European Parliament and the Council in a legislative process regulated by the primary legislation of the European Union.¹⁶ On the other hand, the non-legislative public act under Article 290 of the TFEU is adopted only by the European Commission and does not go through the complex and extensive legislative process. Nevertheless, also in this case the European Parliament and the Council play an important role as they have the power to make objections against the delegated act. If they do so, the act cannot enter into force.¹⁷

With respect to the time schedule for adopting the RTS, it has been clear since the very beginning that the final RTS, after review by the European Parliament and the Council, would not be adopted before the end of summer, thereby leaving a period of a maximum of four months for the insurance market and the national supervisory authorities to prepare for the mandatory distribution of KIDs.¹⁸ This is an extremely short period for creating, testing, printing, and distributing the KIDs by insurance undertakings and other businesses creating investment products. Compared to the standard transposition period for directives which is on average two years,¹⁹ it is becoming increasingly common to see a period of several months or even weeks for the implementation of often very demanding and detailed requirements by the relevant addressees, as a result of the first and second

¹⁴ Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/79/EC.

¹⁵ See Article 10(5) of Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/79/EC.

¹⁶ See TOMÁŠEK, M., TÝČ, V. et al. *Právo Evropské unie*. Praha: Leges, 2013, pp. 111–112; CRAIG, P., BÚRCA, G. *EU Law. Text, Cases and Materials*. 5th ed. Oxford: Oxford University Press, 2011, pp. 113–114.

¹⁷ See Article 290(2)(b) TFEU.

¹⁸ Under Article 8(5) of the PRIIPs Regulation the European supervisory authorities submit the draft RTS to the European Commission by 31st March 2016. Under Article 10(5) of the Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/79/EC, the European Commission has a period of three months to approve the RTS. Under Article 31 of the PRIIPs Regulation, the review period of two plus one month then starts running (or three plus three months if RTS is not approved in identical wording) by both the European Parliament and the Council.

¹⁹ See TOMÁŠEK, M., TÝČ, V. et al. *Právo Evropské unie*. Praha: Leges, 2013, p. 110.

levels.²⁰ It remains questionable whether this practice is an intended consequence of the Lamfalussy structure or an ill-conceived, undesirable side effect. Of course, this is not to say that no other acts of the European Commission are adopted in accordance with Articles 290 and 291 of the TFEU in other policies of the European Union. Nevertheless, it is necessary to state that the acts of the second and third levels adopted in the field of financial services are often essential to the functioning of the entire sector and this is why they represent a major implementation burden for the players if sufficient time is not provided.

The situation may become even more interesting if the delegated act is rejected by the European Parliament and the Council, as was the case with RTS for the PRIIPs Regulation, during the review period.²¹ With respect to the fact that the general duty to create and distribute KID is based on the PRIIPs Regulation, rather than the RTS which only provides for the details of the form and content of these documents, we can imagine two model situations of the impacts on addressees.

When a second level act is rejected within the review period by the European Parliament or the Council, such act does not come into force until the required amendment of the document goes through the entire approval process again.²² Nevertheless, the duty to create and distribute KIDs is based on the level-one act, i.e., in this case the PRIIPs Regulation. This is the reason why immediately with the rejection of the RTS there was a requirement to postpone the applicability of the PRIIPs Regulation, so that the relevant addressees did not have to cope with the general duty to create KIDs without the specification of the form and content of such documents.²³ In the case of PRIIPs, the level-one legislative act has the form of a regulation, which means that on the date of applicability it becomes directly applicable and individuals may rely on it before the courts. If the applicability of the PRIIPs Regulation had not been deferred, the clients would have had the right to receive KIDs in the scope and content specified by the PRIIPs Regulation. The fact that such level-two acts are not ready in time does not release the addressees or the creators of investment products and insurance products with an investment component from the risk of possible private law claims enforcing their liability towards retail investors for failure to provide KIDs.

Alternatively, the applicability of the regulation may be postponed in time so that this level-one act does not become directly applicable to and enforceable against the addressees until the new date of applicability. Until then, the creators of investment products

²⁰ The insurance market is facing a similar situation in the case of implementation of Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution, numerous provisions of which are supposed to be detailed by delegated acts of the European Commission. As these provisions involve (often completely new) matters, such as creating the product and overseeing the product, conflict of interest, incentives and tests of appropriateness and adequacy, it is already clear that these delegated acts of the European Commission and possible guidance documents of EIOPA may have fatal impacts on the operation of the insurance market in the Czech Republic, which will need sufficient time for due implementation of these new essential processes.

²¹ On 14th September an absolute majority of members of the European Parliament rejected the wording of the RTS related to the PRIIPs Regulation submitted by the European Commission.

²² Cf. Article 290(2)(b) TFEU.

²³ See C(2016) 3999 final of 19th September 2016.

and insurance products with an investment component have no duty to distribute KIDs to clients and they cannot be required to do so *de iure*.²⁴

The above leads to an interim conclusion that the first and the second level may yield a benefit of effective regulation only if a sufficient implementation period is provided to the addressees.

THE THIRD AND FOURTH LEVELS OF THE LAMFALUSSY STRUCTURE OR EFFECTIVE COOPERATION BETWEEN THE UNION AND NATIONAL AUTHORITIES IN THE CONTEXT OF UNCLEAR INTERPRETATION OF EU LAW

After the addressees of the above regulations manage to cope with all the duties arising from the level-one and level-two acts, it is not over yet, because the third and fourth levels focus on the supervision and control of enforcement by the national supervisory authorities and the European Commission. This phase is illustrative of the potential impact of different understandings and interpretations of unitary European regulations throughout the EU member states.

We can use for demonstration purposes Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (hereinafter “**Solvency II**”).²⁵ Among others, Solvency II regulates the scope of permitted activities of insurance undertakings, and as a result all insurance companies have to restrict their objects to insurance activities and operations directly derived from them, excluding all other business activities. A sentence that was at first glance relatively easy to understand led to significant interpretation problems and extensive discussions on the Czech insurance market.²⁶ The member states interpret this restriction on the scope of permitted activities of insurance undertakings differently. Many member states consider as transactions resulting from the permitted activities also the mediation of insurance products of other insurance companies or of other banking products (for example consumer loans and mortgages).²⁷ Even the decisions of the Court of Justice of the EU have not created a full list of activities that insurance companies may pursue. The Court of Justice of the EU, however, within the framework of requests for a preliminary ruling on the purpose of this restriction, set the limits for the member states to

²⁴ According to the latest information, the European Commission chose this second model also in the case of the PRIIPs Regulation and, based on a request from the European Parliament and the Council, proposed delayed applicability by twelve months, that is by 1st January 2018. See COM(2016) 709 final, Proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No. 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products as regards the date of its application, of 9th November 2016.

²⁵ Official Journal L 335, 17th December 2009, pp. 1–155.

²⁶ The amendment of Act No. 277/2009 Sb., on insurance, as amended (hereinafter the Insurance Act) changed the former wording of section 6(1) and section 3(1)(n) regulating the institution of so-called related activities. As a result of the literal taking over of Article 18(1)(a) of Solvency II as of the date of effect of the amended Insurance Act, the list of so-called related activities was removed from the law and was not replaced. The amended Insurance Act introduced instead a list of examples of activities directly resulting from the permitted insurance or reinsurance activity.

²⁷ These member states include for example DE, FR, IT, SE, SK, HU, and AT.

follow.²⁸ The purpose of the provision preventing the companies from pursuing other activities than the insurance business is the protection of interests of the insured against the risks that could be imminent if the insurance companies engaged in such business activities that could have an impact on their solvency. Therefore, “any commercial activity other than insurance and transactions resulting from insurance represents a commercial activity that could cause losses capable of endangering the solvency of insurance companies”.²⁹ However, according to the Court of Justice of the EU itself the above conclusions do not present an absolute prohibition on insurance undertakings participating, if only indirectly, in commercial business other than insurance.³⁰ Not every such participation has a negative impact on the objects of the insurance undertakings. In order to maintain the purpose of the restriction it is necessary for the national supervisory authorities to assess the level of risk such an activity may cause. Based on the assessment of such risks, which seem to be minimal, in the case of enabling financial institutions to mediate mutually their financial products, the national supervisory authorities in many member states reached the conclusion that the requirement of protection based on Article 18(1)(a) of Solvency II is fulfilled and allowed such activities.

The lack of a unitary or completely clear interpretation of the ambiguous provisions of the EU regulations on the part of the Court of Justice of the EU results in the fragmentation of the consistent application of EU law throughout the member states. Some players within the internal market may be in a more favourable position than others who are subject to more stringent regulation by their national supervisory authorities.

CONCLUSION: FACTUAL IMPACTS OF THE LAMFALUSSY STRUCTURE ON THE INSURANCE MARKET

In conclusion, it is possible to state that the recent increased regulation of insurance services deserves a review of the impacts of the Lamfalussy structure. It is clear that in cases where it is necessary for the purposes of unitary regulation to integrate in the EU law very specific, complex, and technical details, it is not appropriate to try to include such rules in the level-one legislative acts, and it is better to leave such regulation up to the non-legislative acts of the second and third levels. This solution is also more convenient because the drafters of the acts of the second and third levels are in a better position to assess and stipulate the relevant parameters including various calculations and indicators.

On the other hand, it is necessary to critically admit that for truly effective operation of the financial services market in the EU it is necessary to give the relevant sector sufficient time for implementation of the adopted rules and to lead a constructive dialogue over the

²⁸ See Judgments C-109/99 Association basco-béarnaise des opticiens indépendants, ECLI:EU:C:2000:483; and C-241/97 Försäkringsaktiebolaget Skandia, ECLI: ECLI:EU:C:1999:179.

²⁹ However, this does not prevent insurance companies from holding shares in companies operating such business.

³⁰ The position of the Advocate-General Colomer of 4th April 2000 on the request for preliminary ruling C-109/99 Association basco-béarnaise des opticiens indépendants, ECLI:EU:C:2000:185, point 49: “it does not follow from this conclusion that there is an absolute prohibition on insurance undertakings participating, if only indirectly, in commercial business other than insurance. Not every participation affects the objects of the undertaking”.

realistic impacts of the regulation.³¹ Furthermore, it is not possible to expect that the increased requirements that financial institutions must comply with would not be reflected in the end-user price of the services offered, which certainly is not always in the interest of the consumers. Also, it remains to be seen whether the increased requirements for the financial services sector consisting in greater regulation, unification of all rules for products and distribution, and a daringly short implementation period actually results in a major improvement in consumer protection, which is the stated purpose of most of these rules.

Is increased regulation that reduces the innovative possibilities of financial institutions in creating their products and therefore restricts competition on the internal market really in the interest of consumers? How can the financial institutions flexibly react to the development of digital technologies in the 21st century? These and other questions will certainly be heard in the continuing debate on the future of regulation of the insurance market in the EU.

³¹ Cf. for example SCHAUB, A. The Lamfalussy process four years on. *Journal of Financial Regulation and Compliance*. 2005, Vol. 13, No. 2, pp. 110–120.