

PRODUCT OVERSIGHT AND CUSTOMER DEMANDS AND NEEDS: CONTRACT LAW IMPLICATIONS

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Abstract

One of the Insurance Distribution Directive's main drives is the fight against the misselling of insurance products. This paper identifies the various forms of combatting insurance misselling which are present in the IDD, with an emphasis on product oversight and governance requirements and on the customer demands-and-needs test. In its mission to regulate the market conduct of insurance distributors, the IDD's main focus is on the establishment of legal duties. This paper reflects on the contract law implications of the creation of such legal duties. It does not delve into the national laws of one or more Member States. After concluding that at some point such legal duties become the jural correlatives of individual rights, it maps out, in abstract, the types of pre-contractual or contractual remedies that would best suit the enforcement of such rights by insurance customers as against insurance distributors.

Keywords: insurance distribution; insurance misselling; insurance mismatching; demands-and-needs test; product oversight; governance requirements.

1. Introduction

Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution, known as the Insurance Distribution Directive ('IDD'), is the second of its kind: the first go at minimum harmonization of national laws concerning insurance and reinsurance distribution across the European Union was carried out by Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation, known as the Insurance Mediation Directive ('IMD').

According to Article 42 of the IDD, Member States must transpose it into national laws by 23 February 2018. However, on 20 December 2017, following requests made by the European Parliament and by 16 Member States, the European Commission issued a proposal to postpone the application date of the transposition measures to 1 October 2018¹. The European Commission is also preparing to push back to the same date the application of the two delegated acts adopted under the IDD².

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Unlike its predecessor, the IDD applies to all distribution channels: it applies to any natural or legal person who either is or wishes to be established in a Member State so as to take up and pursue the distribution of insurance and reinsurance products, including insurance undertakings selling their own products directly as well as a variety of insurance intermediaries: insurance agents and brokers, *bancassurance* operators, ancillary insurance intermediaries such as travel agents and car rental companies, and even product comparison websites³. It aims to level the playing field between all types of distributors to ensure that consumers benefit from the same level of protection throughout the marketplace, regardless of their chosen distribution channel⁴.

In its effort to protect insurance customers, one of the IDD's main drives is the fight against the misselling of insurance products. This paper identifies the various forms of combatting insurance misselling which are present in the IDD, with an emphasis on product oversight and governance requirements and on the customer demands-and-needs test. In its mission to regulate the market conduct of insurance distributors, the IDD's main focus is on the establishment of legal duties. This paper reflects on the contract law implications of the creation of such legal duties. It does not delve into the national laws of one or more Member States. After concluding that at some point such legal duties become the jural correlatives of legal rights, it maps out, in abstract, the types of pre-contractual or contractual remedies that would best suit the enforcement of such legal rights by insurance customers as against insurance distributors.

2. The misselling of insurance products: characterizing the problem

Misselling is the wilful or negligent sale of unsuitable products. Some authors provide narrower definitions of misselling, the narrowest being that which requires a fraudulent intent on the part of the distributor⁵. Whilst the deliberate sale of unsuitable products to unsuspecting customers with a view to making a profit at the expense of their misplaced reliance is at the core of the misselling problem, it is submitted that a wider definition such as the one put forward above is better suited to describe the multitude of behaviours which may result in the acquisition, by customers, of unsuitable insurance products.

¹ See the Proposal, 2017. According thereto, the adoption and publication of national measures necessary to comply with the IDD would remain the same as it is, but the entry into force of such national measures, as well as of the repeal of the IMD, would be postponed to 1 October 2018.

² The two Commission Delegated Acts adopted under the IDD are Commission Delegated Regulation (EU) 2017/2358 of 21 September 2017 on product oversight and governance requirements for insurance undertakings and insurance distributors; and Commission Delegated Regulation (EU) 2017/2359 of 21 September 2017 on information requirements and conduct of business rules applicable to the distribution of insurance-based investment products (IBIPs).

³ See Recitals 8, 11, 12 and 16 and Articles 1(2) and 2(1)(1) and (2) of the IDD.

⁴ See Recitals 6, 10 and 16 of the IDD.

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⁵ See Georgosouli, 2014, at. p. 261.

Products may be unsuitable in the sense that they are simply useless: they are a hoax. Nonetheless, this is not what one generally has in mind when specifically referring to misselling. One speaks of misselling mostly when faced with products that in abstract may well suit the needs of a particular group of customers but which are being sold outside that group of customers.

The greater the complexity of the product, the more difficult it is for regular customers to be able to sift through what they are offered and only select products that suit their needs. The greater the complexity of the product, the greater the need for regular customers to rely on the distributor's advice. And here lies our problem: a growing number of evidence is pointing towards the poor quality of financial advice as one of the great sources of customer detriment in financial markets⁶. These include, of course, the insurance market⁷.

In the context of investment products, misselling has been broken down into two different phenomena: aggregate misselling and personal misselling. 'Aggregate misselling' is characterized as "the sale of an investment product based upon the communication of inappropriate expectations of investment returns"⁸. Whenever a salesperson provides an unrealistic account of a product's future performance, whatever the product may be, all customers are equally ill-treated: the problem lies in the provision of inaccurate information on the product. This type of misselling is particularly relevant in the sale of insurance-based investment products. 'Personal misselling' is defined as "the mismatch of the characteristics of an investment product and personal and/or household characteristics"⁹. Mismatching relates to each individual customer differently, because the problem lies not in the product or the information thereon but rather on its suitability to that particular customer. Mismatching can be a serious problem in virtually every class of insurance.

Both types of misselling are directly and indirectly addressed in the IDD, as one of the IDD's key drives is the fight against the misselling of insurance products¹⁰.

3. Product oversight and customer demands and needs: the war on insurance misselling in the Insurance Distribution Directive

In its war on insurance misselling, the IDD's first line of attack targets distributors' professional and organizational requirements: because no one can properly distribute a product unless one has a minimum grasp of what it is for and how it works, the IDD requires all those involved in the distribution of insurance to "possess appropriate knowledge and ability" and undergo "continuing professional training and development"

⁶ See Leece, 2000; Warren, 2007; and Ericson/Fuentes, 2009.

⁷ See Doyle, 2006; Georgosouli, 2014; and Turner, 2016.

⁸ Leece, 2000, at. p. 134.

⁹ Leece, 2000, at. p. 134.

¹⁰ See Recital 44 of the IDD.

so as “to maintain an adequate level of performance”¹¹. This first line of attack is not a novelty: in this regard the IDD merely furthers the work carried out by the IMD¹².

Just as important as ensuring that distributors understand the products they distribute is making sure that customers are given access to information that allows them to understand the product and make up their minds independently, if they so choose, on whether or not to purchase the product. Distributors are required to “provide the customer with objective information about the insurance product in a comprehensible form to allow that customer to make an informed decision”¹³. Hence, the IDD also indirectly tackles misselling by promoting adequate levels of disclosure of information by insurance distributors to their customers or prospective customers. But the weight given to information duties is also not unique to the IDD: one of the IMD’s main concerns was the establishment of the intermediaries’ information duties towards their customers¹⁴. Such is the traditional flow of information: from the insurance distributor to the insurance customer (D → C).

Still within the subject-matter of disclosure duties, the IDD also addresses the very relevant issue of the provision of information on the distributors themselves. Distributors must disclose to their customers whether they provide advice about the products they distribute¹⁵. “It is essential for the customers to know whether they are dealing with an intermediary who gives advice on the basis of a fair and personal analysis”¹⁶. Intermediaries must also disclose whether they are representing the customer or are acting for and on behalf of one or more insurers¹⁷. And all distributors must disclose any relevant information on the existence of conflicts of interest¹⁸. Transparency is key in this respect, because rather than try to comprehend the product in question, or in addition thereto, it is vital that customers know who they are dealing with: they must be put in a position to make an informed decision on whether or not they can safely place their trust on their chosen insurance distributor.

“Impartial advice represents one of the most important financial services consumers can receive”¹⁹.

Numerous empirical studies have shown that some types of distributors, or distribution arrangements, are better than other types of distributors, or distribution arrangements, at

¹¹ See Article 10(1) and (2) of the IDD.

¹² See Article 4 of the IMD.

¹³ Article 20 of the IDD.

¹⁴ See Articles 12 and 13 of the IMD.

¹⁵ Article 18(a)(ii) and (b)(ii) of the IDD.

¹⁶ Recital 47 of the IDD.

¹⁷ Article 18(a)(v) of the IDD.

¹⁸ Article 19 of the IDD.

¹⁹ U.S. Department of the Treasury, 2009, at p. 68.

adequately matching the products they distribute to their customers' demands and needs²⁰.

“[W]hile insurance intermediaries contribute to enhancing transparency in insurance markets, the insurance intermediary market itself is characterized by information gaps since consumers act under asymmetric information about the quality of the information and advisory services provided by the intermediaries”²¹.

The provision of information on the distributors is crucial to enable customers to evaluate how likely a distributor is to provide impartial advice on the product that best suits its needs, particularly in a field such as insurance where oftentimes customers are only able fully to assess the quality of the advice they are given a long time afterwards, usually after the insured risk has occurred²². Nonetheless, because it is always better to be safe than sorry, the IDD also determines that neither the distributors nor their employees should be remunerated or assessed in a way that conflicts with their duty to act in accordance with the best interests of their customers²³.

“While disclosure of specific conflicts of interest is required under Directive (EU) 2016/97, it should be a measure of last resort to be used only where the organisational and administrative arrangements are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of the customer will be prevented since over-reliance on disclosure may result in a lack of effective protection of the customer's interests”²⁴.

Moving on from disclosure duties to those duties which are the main subject-matter of the present analysis: before the traditional flow of information from distributor to consumer even begins, distributors are now meant to apply a demands-and-needs test to their (potential and actual) customers²⁵. Although there was a brief reference to the insurance intermediary's specification of the customer's demands and needs in Article 12(3) of the IMD, this particular component of the fight against misselling was positively catapulted to the frontline in the IDD.

Firstly, insurers must maintain, operate and review product oversight and governance arrangements aimed at identifying each product's target market, at ensuring that all relevant risks of that target market are assessed and that the product is and remains

²⁰ See Focht/ Richter/ Schiller, 2013, for empirical evidence that independent agents and brokers do better at matchmaking than exclusive or semi-exclusive agents. For earlier research which supports this finding, see L. Regan/ S. Tennyson, 1996; and L. Regan, 1997. See also R. Inderst/ M. Ottaviani, 2009; and R. Inderst, 2011. The authors provide evidence that misselling “depends on features of the agency problem including: the internal organization of a firm's sales process, the transparency of its commission structure, and the steepness of its agents' sales incentives” (R. Inderst/ M. Ottaviani, 2009, at p. 883).

²¹ Eckardt/ R athke-D oppner, 2010, at p. 667.

²² Eckardt/ R athke-D oppner, 2010, at p. 667.

²³ Article 17(3) of the IDD.

²⁴ Recital 5 of Commission Delegated Regulation (EU) 2017/2359.

²⁵ Article 20 of the IDD.

consistent with the needs of that target market throughout its lifetime²⁶. Hence, even before a product is commercialized, target groups must be identified and their typical demands and needs assessed, so that the product's design matches such typical demands and needs²⁷. The aim of this requirement is, therefore, "to avoid and reduce from an early stage risks of failure to comply with customer protection rules"²⁸. Because insurance contracts, much like any other products, should be fit for purpose.

Product oversight and governance measures are to apply "in a proportionate and appropriate manner, depending on the complexity of the product and the degree to which publicly available information can be obtained, taking into account the nature of the insurance product and the risk of consumer detriment related to it, the characteristics of the target market and the nature, scale and complexity of the relevant business of the manufacturer or distributor"²⁹.

This line of attack targets wholly unsuitable products: such products are now forbidden. Insurers must only distribute products that are useful to someone.

Secondly, when marketing their products, all distributors must direct their efforts only at those prospective customers that belong to the target market. That is to say, they must abstain from actively seeking to sell such products to someone other than the persons who may find them useful. Insurers' distribution strategy must be consistent with the findings of the first stage of this process, where the target market was identified, and they must "take reasonable steps to ensure that the insurance product is distributed to the identified target market"³⁰.

Thirdly, all insurance distributors must pay attention to the individual demands and needs of their actual customers. Rather than flood their customers with information, insurers must take note of their demands and needs, it being their job to find a product that suits them:

²⁶ Article 25 of the IDD. This provision does not apply to insurance products which consist of the insurance of large risks: Article 25(4) of the IDD.

²⁷ See also Recital 55 of the IDD and Commission Delegated Regulation (EU) 2017/2358 and 2359. For further information, see EIOPA's Final Report on Public Consultation on Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and insurance distributors, see EIOPA Final Report on Public Consultation on Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and insurance distributors, of 06.04.2016; EIOPA Technical Advice on possible delegated acts concerning the Insurance Distribution Directive, of 01.02.2017; EIOPA Guidelines under the Insurance Distribution Directive on Insurance-based investment products that incorporate a structure which makes it difficult for the customer to understand the risks involved, of 04.10.2017; and EIOPA Final Report on Guidelines under the Insurance Distribution Directive on Insurance-based investment products that incorporate a structure which makes it difficult for the customer to understand the risks involved, of 11.10.2017.

²⁸ Section 1 of the Explanatory Memorandum of Commission Delegated Regulation (EU) 2017/2358.

²⁹ Recital 2 of Commission Delegated Regulation (EU) 2017/2358. See also its Article 4.

³⁰ Article 25(1) of the IDD. See also Article 8, 10 and 11 of Commission Delegated Regulation (EU) 2017/2358.

“Any contract proposed shall be consistent with the customer’s insurance demands and needs”³¹.

This is where the IDD most directly addresses the phenomenon previously referred to as personal misselling: the mismatching of insurance products and actual insurance customers: distributors are now required adequately to match the products they distribute to their customers’ demands and needs.

This duty to match, rather than mismatch, entails the prior collection of information on customers’ circumstances and concerns³². Hence, the IDD appears to strike a new balance between the traditional and a new and reverse flow of information: from the insurance customer to the insurance distributor (D → I).

No further guidance is provided on the information that must be collected from customers, except in the case of the distribution of insurance-based investment products³³.

4. Contract law implications

The IDD is aimed at minimum harmonization of national laws concerning the business of insurance and reinsurance distribution across the European Union. Hence its more direct focus is on the distributors’ activity and not so much on the contracts they enter into or facilitate. Chapter VII, on sanctions and other measures, is limited in its scope to setting minimum sanctions of an administrative nature for all infringements of the national provisions implementing the IDD, and further clarifies that in addition to those sanctions Member States may also provide for and impose criminal sanctions³⁴. No reference is directly made to consequences of a contractual or pre-contractual nature of a distributor’s failing to comply with conduct of business requirements. In that regard, the IDD merely refers to the procedural side of potential conflicts, placing upon Member States the duty to ensure the establishment of “adequate and effective, impartial and independent out-of-court complaint and redress procedures for the settlement of disputes between customers and insurance distributors concerning the rights and obligations arising under this Directive”³⁵.

It is not surprising that it should be so, given that it is grounded on Articles 53(1) and 62 of the Treaty on the Functioning of the European Union: the most central aim of the

³¹ Article 20(1) of the IDD.

³² Article 20 of the IDD. See also Recitals 44 and 45 of the IDD. There was but a hint of this requirement of an insurance intermediary to collect information from its clients and advise them accordingly in Article 12(3) of the IMD.

³³ The information that distributors of such products must obtain from their customers for the purposes of the assessment of suitability and appropriateness is that which is set forth in Article 30 of the IDD, as further developed in Articles 9 and 17 of the Commission Delegated Regulation (EU) 2017/2359, whose provisions are said to be “largely aligned with the standards set under MiFID II” (Section 1 of the Explanatory Memorandum).

³⁴ See Articles 31 to 36 of the IDD.

³⁵ Article 15(1) of the IDD.

IDD is to make it easier for persons to take up and pursue activities within its territory as self-employed persons. This is a public law purpose: that of regulating the taking-up and pursuit of the activities of insurance and reinsurance distribution in the internal market. However, another area where there is shared competence between the European Union and Member States is that of consumer protection³⁶. Although the relevant provisions of the TFEU are not directly mentioned in the IDD, it is obvious that in regulating insurance and reinsurance distribution the IDD is also trying to promote the interests of consumers and achieve a high level of consumer protection. As it should: “Consumer protection requirements shall be taken into account in defining and implementing other Union policies and activities”³⁷.

Whilst the IDD does not directly set forth any private law rules on the pre-contractual and contractual relationship between the insurers and insurance intermediaries and their customers, which remain something for national legal systems to cater for, it may safely be argued that the IDD implicitly demands that such rules exist, that it implicitly assumes that judicial redress will be available to resolve any disputes which may arise between them and explicitly requires the existence of quicker and less expensive alternative dispute resolution mechanisms for the settlement of such disputes³⁸.

The disputes in question are those “concerning the rights and obligations arising under this Directive”³⁹. It is crucial to understand the exact meaning of this reference because this is where pre-contractual and contractual implications enter the legal stage⁴⁰.

In its mission to regulate the market conduct of insurance distributors, the IDD’s main focus is on the establishment of legal duties. All such legal duties were created so as to protect some public interest. Abiding by such legal duties does not always take place in the context of direct relationship between insurance distributors and specific insurance customers. For instance, when designing and implementing product oversight and governance strategies, distributors are acting to protect insurance customers in general, no individual customer being entitled to demand performance of such legal duties. However, at some point in time those individual customers will come into play and individual relationships will be formed as between distributors and their customers.

This express reference to disputes concerning the rights and obligations arising under the IDD is a clear indication that there comes a point when such duties become the jural correlatives of individual rights. In other words, in the process of regulating the insurance and reinsurance distribution activity and creating such legal duties, the IDD must have simultaneously bestowed upon insurance customers the corresponding claim rights, in

³⁶ Article 4(2)(f) of the TFEU.

³⁷ Article 12 of the TFEU. See also Article 169 of the TFEU.

³⁸ See also Recital 38 of the IDD.

³⁹ Article 15(1) and (2) of the IDD.

⁴⁰ As Leczykiewicz, 2013, has pointed out, at p. 199, “[i]t is a misconception that EU law is not interested in private law relationships”.

the Hohfeldian sense⁴¹. Exactly how these claim rights can be enforced will depend upon the applicable national law. But the IDD requires national laws somehow to acknowledge the existence of these claim rights and to render them enforceable as against such insurance distributors.

This is an instance of the phenomenon aptly called a ‘spillover’ from EU law into national law: this particular type of ‘spillover’ happens when a harmonizing directive lays down rights and/or duties yet refrains from detailing the remedies that should apply to the breach of such rights and the procedures that should be followed to enforce such rights, which are then open for regulation at national level⁴².

According to the European Court of Justice, “it is settled case-law that in the absence of Community rules governing the matter it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from Community law, provided, however, that such rules are not less favourable than those governing similar domestic actions (the principle of equivalence) and do not render virtually impossible or excessively difficult the exercise of rights conferred by Community law (the principle of effectiveness)”⁴³.

This paper is not meant to delve into the national laws of one or more Member States. Its purpose is merely to analyse and map out, in abstract, the types of pre-contractual or contractual remedies that would best suit the interests of insurance customers who wish to exercise their claim rights vis-à-vis their chosen distributors.

For the purpose of this exercise I shall focus on the problem of mismatching. Let us consider the case of a distributor who sold product liability insurance to cork manufacturers⁴⁴. Such manufacturers’ main concern was the risk of defective corks ruining the wine of their client wineries. The product, as sold, was useless to these customers, because product liability is meant to deal with damage caused by defective products to consumers⁴⁵. No one detected the inconsistency at the contracting stage, hence no extension covering damage caused to their non-consumer direct customers was

⁴¹ See Hohfeld, 1913, from p. 28 onwards.

⁴² See Johnston, 2013, at pp. 361-365.

⁴³ This excerpt is taken from Case C-63/01 *Samuel Sydney Evans v Secretary of State for the Environment, Transport and the Regions and The Motor Insurers’ Bureau* at § 45. However, the ECJ has stated it almost *verbatim* in numerous judgments, both before and after *Evans*. See Case C-33/76 *Rewe-Zentralfinanz v Landwirtschaftskammer für das Saarland*; Case C-45/76 *Comet BV v Produktschap voor Siergewassen*; Case C-158/80 *Rewe-Handelsgesellschaft Nord GmbH v Hauptzollamt Kiel*; Case C-312/93 *Peterbroeck, Van Campenbout & Cie SCS v Belgian State*; Case C-261/95 *Rosalba Palmisani v Istituto Nazionale della Previdenza Sociale (INPS)*; Case 120/97 *Upjohn Ltd v The Licensing Authority established by the Medicines Act 1968 and Others*; Case C-453/99 *Courage Ltd v Bernard Crehan*; Case C-467/01 *Ministero delle Finanze v Eribrand SpA*; Case C-13/01 *Safalero Srl v Prefetto di Genova*; Case C-295/04 *Vincenzo Manfredi v Lloyd Adriatico Assicurazioni SpA*; Case C-432/05 *Unibet (London) Ltd and Unibet (International) Ltd v Justitiekanslern*.

⁴⁴ An example based on a real-life trend which I have personally come across whilst working as a legal practitioner some years ago in Portugal.

⁴⁵ See the Product Liability Directive (Directive 85/374/EEC).

negotiated. When it comes to insurance, such problems are often only identified when the dreaded event occurs and the insurer rejects the claim for compensation for loss sustained by the insured.

A traditional response to the problem of mismatching may be found in the doctrine of mistake. In one form or another, this doctrine is present in both civil law and common law legal systems. Its unifying feature is that it leads to the avoidance of contracts *ab initio*⁴⁶. In the context of a sale of goods, this remedy is often the most appropriate: the customer drops any unsuitable goods and replaces them with suitable goods. When it comes to insurance, however, the opportunity to purchase suitable cover is irredeemably lost. You cannot go back in time and neither can you insure today against a loss you have knowingly sustained yesterday. Hence, such a response would be almost wholly ineffective: the most that the cork manufacturer could get under this doctrine would be a reimbursement of the insurance premium.

The cork has ruined the wine. A substantial amount of loss has been sustained by the winery. The winery has sought compensation from the cork manufacturer. The cork manufacturer's insurance did not cover loss caused to the winery. The cork manufacturer cannot go back to the market and replace the unsuitable insurance with a suitable insurance. So all it can do is sue the distributor for non-compliance with its duty to provide an insurance product which is consistent with the customer's insurance demands and needs.

What judicial remedies are available in this context? What can the cork manufacturer claim from the distributor and on what legal grounds? The most obvious answer to this question lies in the institute of pre-contractual liability: *culpa in contrahendo* or its common law counterparts⁴⁷. There is no need for us to revisit the general discussions on the standards of conduct which apply to negotiating parties in each particular legal system, most particularly on whether contracting parties must act fairly to one another and abide by the principle of good faith when negotiating a contract, because in this particular context the duties in question do exist and are what gave rise to this analysis in the first place: they are the duties of conduct set forth in the IDD.

The distributor is under a duty to provide an insurance product which is consistent with the customer's insurance demands and needs. If it fails to do so, it should be liable for the corresponding loss. The question that follows, if one goes through this road, is how to measure the cork manufacturer's actual loss and set the corresponding compensation amount. Simply placing it in the position it would have been in had no insurance been contracted at all would clearly not suffice. This would, again, limit its claim to a mere reimbursement of the insurance premium. Another possibility would be to compensate it only for its loss of the opportunity to seek proper insurance cover elsewhere. Such a possibility would admittedly be very hard to measure. In order to make the cork

⁴⁶ See Morgan, 2012, pp. 163-184.

⁴⁷ As to which, see Kessler/Fine, 1964.

manufacturer whole, it should be put in the position it would be in had the distributor fulfilled its duty to propose a contract that would be consistent with the customer's insurance demands and needs, if such an offer existed, or not to propose a contract at all, if such an offer were unavailable, either in the marketplace or in its portfolio, depending on the type of distributor⁴⁸. Assuming that a suitable offer existed, damages should ideally seek to place it in the position it would have been in had the proper insurance product been offered and accepted in the first place: they should equal the indemnity that would have been due under that contract, minus the surplus premium that would have been paid to the insurer.

Another possible course of action, this time only as against the insurer, would be based on performance of the contract, rather than liability for pre-contractual misconduct: the mismatching would be qualified as a sale of defective products and, under the contract that has been entered into, the customer would demand that the insurer retroactively replace the defective cover with a cover which is consistent with the customer's demands and needs⁴⁹. Some law-and-economics authors are moving close to this line of reasoning when, in the context of massively distributed boilerplate contracts – a phenomenon that also happens in insurance – they argue that customers are actually purchasing a composite of item-plus-terms rather than just the item itself, the implication being that when some terms are inappropriate we might classify them as defective and move to apply the rules on the sale of defective products⁵⁰. In the case of insurance, there is no separation between the item and the contract terms, as the terms *are* the product, as has been rightly pointed out elsewhere⁵¹.

5. Conclusion

Misselling is the wilful or negligent sale of unsuitable products. Products may be unsuitable in the sense that they are simply useless, but this is not what one generally has in mind when specifically referring to misselling. One speaks of misselling mostly when faced with products that in abstract may well suit the needs of a particular group of customers but which are being sold outside that group of customers.

In its war on insurance misselling, the IDD requires all those involved in the distribution of insurance to have appropriate knowledge and skills and undergo continuing professional training and development so as to maintain an adequate level of performance. The IDD requires distributors to provide their customers or potential

⁴⁸ See Article 20(1) of the IDD.

⁴⁹ This solution would adopt similar remedies to those already set forth in the Consumer Goods Directive. In the U.S., Warren, 2007, famously pointed out at the similarities between consumer goods and financial services: “Consumers can enter the market to buy physical products confident that they won’t be tricked into buying exploding toasters and other unreasonably dangerous products. They can concentrate their shopping efforts in other directions, helping to drive a competitive market that keeps costs low and encourages innovation in convenience, durability, and style. Consumers entering the market to buy financial products should enjoy the same protection”.

⁵⁰ See Baird, 2006; and Radin, 2017, at pp. 529-531.

⁵¹ See Dreher, 1991.

customers with information on the product and on the distributors themselves. Conflicts of interest are especially targeted herein. Transparency is key in this respect, because rather than try to comprehend the product in question, or in addition thereto, it is vital that customers know who they are dealing with: they must be put in a position to make an informed decision on whether or not they can safely place their trust on their chosen insurance distributor.

Such is the traditional flow of information: from the insurance distributor to the insurance customer (D → C). But before it even begins, distributors are now meant to apply a customer demands-and-needs test. They must maintain, operate and review product oversight and governance arrangements. This requirement targets wholly unsuitable products: such products are now forbidden. Insurers must only distribute products that are useful to someone. When marketing their products, distributors must direct their efforts only at those prospective customers that belong to the target market. Finally, distributors must pay attention to the individual demands and needs of their actual customers. Rather than flood their customers with information, insurers must take note of their demands and needs, it being their job to find a product that suits them. This duty to match, rather than mismatch, entails the prior collection of information on the insurance customer. Hence, the IDD appears to strike a new balance between the traditional and a new and reverse flow of information: from the insurance customer to the insurance distributor (D → I).

The IDD's most central aim is to make it easier for persons to take up and pursue activities within its territory as self-employed persons. However, in doing so, it is also trying to promote the interests of consumers and achieve a high level of consumer protection. In its mission to regulate the market conduct of insurance distributors, the IDD's main focus is on the establishment of legal duties. However, the IDD's express reference to disputes concerning the rights and obligations arising under the IDD is a clear indication that there comes a point when such duties become the jural correlatives of individual rights.

Exactly how these claim rights can be enforced will depend upon the applicable national law. But the IDD requires national laws somehow to acknowledge the existence of these claim rights and to render them enforceable as against such insurance distributors. The remedies and procedures set forth in national laws must comply with the principle of equivalence, as such rules must not be less favourable than those governing similar domestic actions, and with the principle of effectiveness, not rendering it virtually impossible or excessively difficult for insurance customers to the exercise their individual rights as against insurance distributors.

Not all contractual or pre-contractual remedies are equally effective in protecting insurance customers. In insurance, the opportunity to purchase suitable cover is irredeemably lost after the fact. You cannot go back in time and neither can you insure today against a loss you have knowingly sustained yesterday. Hence, remedies that render the contract void *ab initio* or that place the customer in the position it would have been in

had no contract been concluded at all are ineffective. The most obvious remedy, in this context, is based on the institute of pre-contractual liability: *culpa in contrabendo* or its common law counterparts. In order to make the customer whole, it should be put in the position it would be in had the distributor fulfilled its duty to propose a contract that would be consistent with the customer's insurance demands and needs, if such an offer existed, or not to propose a contract at all, if such an offer were unavailable, either in the marketplace or in its portfolio, depending on the type of distributor. Assuming that a suitable offer existed, damages should ideally seek to place it in the position it would have been in had the proper insurance product been offered and accepted in the first place: they should equal the indemnity that would have been due under that contract, minus the surplus premium that would have been paid to the insurer.

Another possible remedy would be based on performance of the contract, rather than liability for pre-contractual misconduct: the mismatching might be qualified as a sale of defective product and, under the contract that has been entered into, the customer would then be entitled to demand that the insurer retroactively replace the defective cover with a cover which is consistent with the customer's demands and needs.

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