

Development of the Regulation of Insurance Intermediaries in the Czech Republic¹

Martina Krügerová²

DOI: 10.36250/00749.33

JEL Classification: K20, G22, F36

Abstract

In the insurance market, various distribution channels can be selected to distribute an insurance coverage. The selection of those channels depend on many factors and specific criteria. The insurance intermediaries represent the main channel for external distribution channels (also called the intermediary channel). The aim of this article is to summarise the legal regulation of insurance intermediaries and to show changes in the development of registered intermediaries.

Keywords

regulation of insurance; insurance intermediary; external distribution of insurance; internal distribution of insurance

1 Introduction

For several years, the global insurance industry (including insurance intermediaries) has been facing an enormous amount of regulatory requirements³ that have different impacts on the insurance sector. Each insurance market is different; differences stem from the different history, demographics, education, financial literacy of consumers, risk management, market cultivation, etc., and therefore, the impacts of regulatory

¹ This paper was supported by the Operational Programme of Education for Competitiveness – Project no. CZ.1.07/2.3.00/20.0296.

² Ing., PhD, Department of Law, Faculty of Economics VŠB, Technical University of Ostrava, the Czech Republic. The author specialises in insurance intermediaries and insurance law. Contact email: martina.krugerova@vsb.cz.

³ An overview of the current legislation regulating the insurance industry is compiled in e.g. Mesršmíd, 2015.

requirements on the insurance sector differ in individual states. At the same time, the insurance industry is a dynamically developing market, which must cope not only with new regulations, but also respond to economic development, the situation in financial markets, the emergence of new risks, changes in risk management, consumer preferences and their needs.

In the insurance market, various distribution channels can be selected for distribution of insurance coverage. The selection of those channels depend on many factors and specific criteria. Economic assessment and legal aspects of the considered distribution channel are being evaluated. Not only economic and legal assessment of the considered distribution channel is being provided but other criteria, as well.⁴ The above mentioned insurance intermediaries are important distribution channels. Insurance intermediaries are the entrepreneurs, either a natural or legal person, who, for payment, provide insurance intermediary activities on the basis of Act No. 38/2004 Coll., on Insurance Intermediaries and Independent Loss Adjusters and on the amendment to the Trade Licensing Act (hereinafter: Act on Insurance Intermediaries). The categories of insurance intermediaries should be amended by the new Act on insurance and reinsurance distribution.

The Czech authors dealing with the issue of development of the regulation in the insurance industry primarily include researchers such as Ducháčková and Daňhel, Mesřmíd and Vávrová. Ducháčková and Daňhel (2012) describe changes in the status of the insurance sector triggered by the processes associated with globalisation and crisis. In his books, Mesřmíd (2015) defines selected areas of the European law and the current developmental stages of insurance industry regulation in the EU. Vávrová (2013) in her article analyses the regulatory measure known as Solvency II and the process of its implementation. Hrabalová et al., (2017) analyse the impact of the financial crisis on insurance markets in global aspects. In their article, Vávrová and Nečas (2016) review the development of the financial health of the global insurance market during the lingering financial crisis.

The paper focuses on insurance intermediaries as part of the insurance market. The methods of description, analysis, synthesis and comparison will be applied. The aim is to summarise the legal regulation of insurance intermediaries and to show changes in development of registered intermediaries. The conclusion will include some current problems and trends in the insurance intermediaries. Data used in this article are collected from annual reports provided by the institution of the Czech insurance market mainly the Czech National Bank⁵ (CNB), the Czech Statistical Office and annual report of the Ministry of Finance. The statistical data show the development of insurance intermediaries in the Czech insurance market.

⁴ More details in Krügerová, 2017.

⁵ The Czech National Bank as the regulator of the financial market publishes the lists of regulated and registered subjects of the financial market, the lists are maintained since 1 January 2009.

2 Regulation and Statistics of Insurance Intermediaries

The distribution of insurance products and some related issues are regulated in the Czech legal order:⁶ Act No. 38/2004 Coll., on Insurance Intermediaries and Independent Loss Adjusters; Act No. 277/2009 Sb., on the insurance industry; Act No. 89/2012 Sb., Civil Code; Regulation No. 582/2004 Coll., to apply some law regulations on insurance intermediaries and liquidators of insurance events are processed.

European rules for the distribution of insurance products are regulated in the insurance market:⁷ IDD Regulation [Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution]; PRIIPs Regulation [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]; Solvency II (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).

An important milestone for insurance intermediaries is April 1, 2000, when Act No. 363/1999 Coll., on the insurance industry came into effect. This was the first step toward the legal registration of insurance intermediaries. Intermediary activities are regulated by Section 25 of the Insurance Act. The Insurance Act has defined insurance intermediary activities in Section 2, Letter f) as a professional activity leading to the conclusion of insurance or reinsurance contracts and associated activities. This activity could be performed from two directions, by an insurance agent and by an insurance or reinsurance broker.

An insurance agent was thereof considered a natural or legal person who carries out intermediary activities under their contract with the insurance company. This means that the agent acted on behalf of and for the account of the insurance company. An insurance or reinsurance broker was defined as a natural or legal person who carries out intermediary activities under their contract with the insurance applicant, which is a legal or natural person who is interested in signing insurance or reinsurance contracts (Act No. 363/1999 Coll.). The description of the insurance agent and insurance broker remained essentially the same even in the Act on Insurance Intermediaries.

Insurance intermediaries were required to carry out the insurance intermediary activities with professional due diligence and had to meet the legal conditions. However, neither the credibility nor the expertise of the insurance intermediaries was a condition for their activities. Consumer protection was therefore insufficient. For the first time, the obligation to register was established with the Ministry of Finance, but only for the insurance broker category. But no register has been instituted. The Ministry of Finance finally responded to the market initiatives and has made the list of brokers who have met the conditions to be registered set by law, available on its website. The client

⁶ For more details see Ducháčková and Daňhel, 2012; Mesršmíd, 2015.

⁷ In more detail see Krügerová, 2016 and Mesršmíd, 2015.

could thus take an opportunity to verify whether the client works with a registered broker. Because the brokers act on behalf of the insurance company and on its account, by law-makers, the registration had not been necessary.

Table 1 shows a development of the registered insurance brokers by the Act No. 363/1999 Coll., on the insurance industry. The same information about insurance agents is not available because those had no obligation to register; therefore, when elaborating annual reports, only average numbers are being worked with, which individual insurance companies report. In 2001, there were about 35,000 insurance intermediaries in the Czech Republic. Nevertheless, the real number was lower because a higher fluctuation of insurance agents has to be taken into account, as well as the fact that one agent could work on behalf of more insurance companies. As for the commercial service of insurance companies, there were 4,351 employees, out of which 3,068 concluded insurances. In 2004, there were 45,000 agents in the market and about 600 brokers and both groups had about 10,000 co-workers.

Table 1. Development of registered insurance brokers by the Act on the insurance industry

	2000	2001	2002	2003
Registered total	236	337	430	526
Insurance broker	212	289	358	426
Reinsurance broker	2	2	5	3
Insurance and reinsurance broker	22	46	67	97

Source: Compiled by the author based on the annual report of the Ministry of Finance of the Czech Republic 2000, 2001, 2002, 2003.

The legislation on the execution of intermediary activities in the insurance sector under the Insurance Act was short and inadequate. Consumer protection was insufficient. The change in regulation was necessary.

The most important ones include an increase in client protection, development and new trends in the insurance market. However, the key reason was an obligation to harmonise our law with EC law⁸ as one of the prerequisites for the Czech Republic entry to the European Union. In the area of insurance intermediaries, it was Directive 2002/92/EC on Insurance Mediation (the “IMD1 Directive”).

The member states were obligated to transpose the IMD1 Directive into their national legal orders by January 15, 2005. The Czech Republic has met the deadline by the adoption of Act No. 38/2004 Coll., on Insurance Intermediaries and Independent

⁸ The first try of insurance intermediaries’ regulation, Council Directive 77/92/EEC of 13 December 1976 on measures to facilitate the effective exercise of freedom of establishment and freedom to provide services in respect of the activities of insurance agents and brokers (ex ISIC Group 630) were, in particular, transitional measures in respect of those activities. This directive implemented a temporary regime, which enabled the agents and brokers to extend their activities beyond the border of their home state. To make it of higher quality, a new directive was adopted on 9 December 2002, 2002/92/EC, on Insurance Mediation (IMD1).

Loss Adjusters and the amendment to the Trade Licensing Act, as amended with effect as of January 1, 2005.

Act No. 38/2004 Coll., on Insurance Intermediaries and Independent Loss Adjusters (Act on insurance intermediaries) defines significant terms, regulates the activities of insurance intermediaries and independent loss adjusters, establishes a register of insurance intermediaries and independent loss adjusters, defines the conditions for start-up of activities of insurance intermediaries under the right to establish branch offices, or the freedom to provide services and the execution of state supervision of the activities of intermediaries and independent loss adjusters (Act No. 38/2004 Coll.).

In connection with adopting the Act on insurance intermediaries, about 43,000 insurance intermediaries were expected to register of both forms of natural and legal person. It was assumed that some of the intermediaries would have to end their activities because they would not be able to meet the given conditions of the Act on insurance intermediaries and that small intermediaries would unite, mainly brokers, in order to lower administrative costs. By the Czech Statistical Office (Figure 1), within 2004 and 2005, the number of intermediaries increased up to the end of 2004 while the beginning of 2005 showed a decreasing tendency.

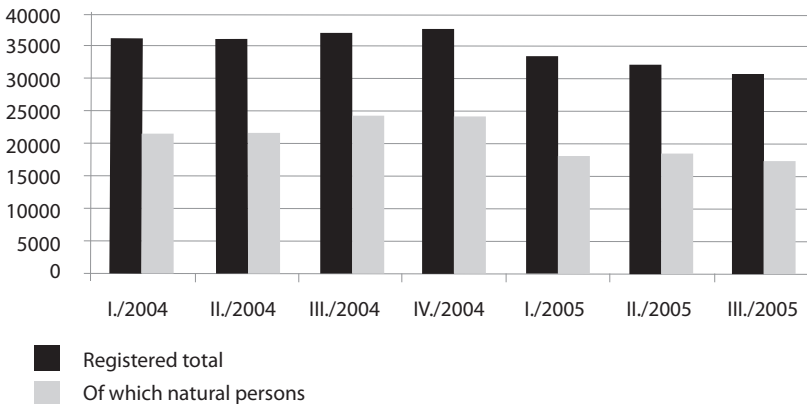


Figure 1. The number of registered insurance intermediaries within 2004 and 2005

Source: The Czech Statistical Office

Intermediaries used simpler conditions to start their activities and tried to start their business up to the end of 2004. By this fact, they could also use the temporary provision of the Act on insurance intermediaries (Art. 29). In 2005, they are seen as factually registered intermediaries.

The Ministry of Finance registered 40,203 people in total up to 8 March 2006, out of which number 38,478 (95.7%) were natural persons and 1,725 (4.3%) legal persons. As for the increase of registered people, a typical postponing of duties fulfilment is

seen at the end of a determined term given by the law. The deadline for intermediaries already making business to submit the application to be registered before the date of the Act on insurance intermediaries effect was set half a year after the Act on insurance intermediaries came into force, i.e. up to 1 July 2006.

The act on insurance intermediaries allows to act as an intermediary in the insurance business in the following six categories: a tied insurance intermediary, a subordinate insurance intermediary, a fixed insurance agent, an insurance agent, an insurance broker and an insurance intermediary with a home member state other than the Czech Republic.

In terms of the changes, closer attention will be paid in the text below to the first five categories of insurance intermediaries. The activity of insurance intermediaries is not licensed business. By the Trade Code, intermediaries are the entrepreneurs making business based on other than licensed one; in this case based on the permission of state supervision made by the Czech National Bank (registration). The insurance intermediary is obligated to register in the Register of insurance intermediaries, maintained by the Czech National Bank,⁹ and may carry out intermediary activities only in such position and category, in which they are registered. The intermediary could be registered in more positions.

Continual development of the number of intermediaries is shown in Table 2 and Figure 2. The number of insurance intermediaries has an increasing tendency in the market. The most stable category of insurance are brokers. Contrary to that, other categories show more noticeable increase. The most significant increase is seen at subordinated insurance intermediaries; this category is assumed to have the biggest number of non-active intermediaries.

Table 2. Development of registered insurance intermediaries by the Act on insurance intermediaries

Year	Total	of which				
		PM	PA	VPA	VPZ	PPZ
2009	91,063	638	1,183	23,222	10,964	55,056
2010	109,913	689	1,284	27,946	11,814	68,180
2011	132,577	729	1,368	32,329	12,282	85,869
2012	139,175	749	1,399	33,980	12,298	90,749
2013	150,418	782	1,452	36,780	12,676	98,728
2014	157,246	790	1,442	38,709	12,751	103,554
2015	162,956	780	1,393	40,014	12,917	107,852
2016	167,820	783	1,379	41,448	12,822	111,388
2017	174,581	782	1,362	42,227	12,757	117,453

Note: PM – insurance broker; PA – insurance agent; VPA – fixed insurance agent; VPZ – tied insurance intermediary; PPZ – subordinate insurance intermediary.

Source: Compiled by the author based on cnb.cz., 2018.

⁹ The state supervision of the operation of insurance intermediaries, who are registered in the Czech Republic or in the territory of the third state is carried out by the Czech National Bank (the CNB).

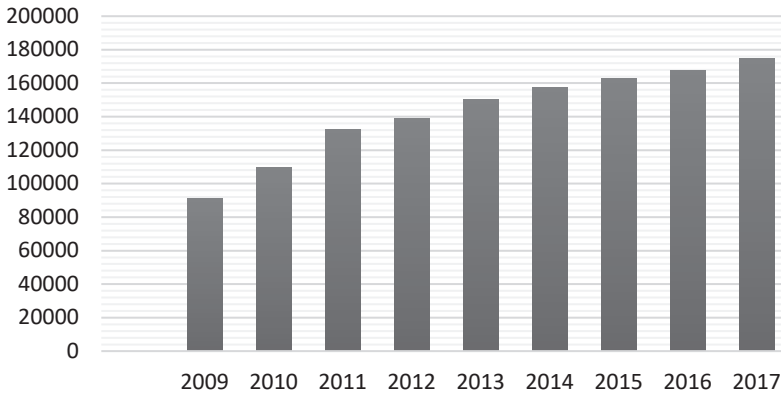


Figure 2. Development of the total registered insurance intermediaries by the Act on insurance intermediaries

Source: Compiled by the author based on cnb.cz., 2018.

As time went on, it became apparent that the Regulation is not suitable enough. An adjusting of just one distributor channel proved to be short-sighted so the adjustment was extended to other ways of insurance mediation. The European Commission published a draft of new regulation on insurance mediation in the beginning of July 2012 – Insurance Mediation Directive (IMD2). In the frame of the legislative process, this regulation was renamed in September 2014 to Insurance Distribution Directive (IDD) [Directive (EU) 2016/97]. The new name reflected its focus on regulating the distribution of insurance products, including direct insurers where no intermediation occurs. IDD regulates the activities of insurance intermediaries, insurance companies, their employees, ancillary insurance intermediaries as well as online distribution. The regulation IDD should have been transposed up to 23 February 2018 at the national level. It should come into force on 1 October 2018 (Krügerová, 2016). The EU Council has postponed the term of transposition at the national level up to 1 July 2018, its effect remained the same. This way, the member states have gained more time to prepare themselves to make such a fundamental legislative change.

In the Czech Republic, the directive first should be implemented by the amendment to the Act on Insurance Intermediaries and Independent Loss Adjusters (The bill amending Act No. 38/2004 Coll.). The amendment had been prepared since 2012, and was often criticised that it should be adopted before the final version of the directive on insurance mediation (distribution). After a reviewing process, there was a bill of the act on insurance distribution prepared for exchanging the current act on insurance intermediaries and liquidators of insurance events. As this paper was written, the bill was not accepted into the legal order. Nevertheless, regarding the transposition term, its acceptance is not being obstructed by anything and it is supposed to be issued in the Statute book at the turn of August and September.

The new act in accordance with the regulation brings several changes and it changes many important aspects of insurance intermediaries' regulation. The change will be made mainly in the categorisation of insurance intermediaries, a request for professionalism of people acting in insurance industry will be intensified. The bill extends a scope of regulation towards a direct sale of insurance in insurance companies' offices (by their employees). The categorisation of intermediaries will be new: independent intermediary, intermediary undertaking and ancillary intermediary. Independent intermediary currently includes both broker and agent under the condition that those activities cannot be done in the frame of one particular insurance policy. The fact that an agent mediates the insurance for the insurance company and a broker only for the customer remains the same. Intermediary undertaking mediates the insurance only for one subject. Ancillary intermediary¹⁰ is a newly implemented category. Those intermediaries mediate the insurance only as their ancillary activity. Contrary to intermediary undertaking, this can make their activities also for more subjects. The category insurance intermediary seated in another EU member state remains the same. The distribution of insurance and reinsurance is conditioned by permission gained from the Czech National Bank (CNB) or by entering the register of intermediaries. According to the new regulation, the person in position of one type of insurance intermediary cannot be registered in the register in position of another insurance intermediary.¹¹ Permission to provide with intermediary activity is newly limited to a one year period, and, if fee would not be paid, then the registration expires (The bill amending Act No. 38/2004 Coll.).

2.1 Actual problems

Recently, the regulatory measures of Solvency II (Directive 2009/138/EC), application IFRS 4, guarantee schemes in the insurance industry; the regulation of insurance distribution, as well as the regulation of PRIIPs [Regulation (EU) No. 1286/2014], whose aim is to support/achieve greater integration, globalisation and functioning of the single insurance market in EU countries, have the greatest impact on the insurance sector. The Directive constitutes an essential instrument for the achievement and functioning of the internal market; insurance and reinsurance undertakings authorised in their home Member States should be allowed to pursue, throughout the Community, any or all of their activities by establishing branches or by providing services.

¹⁰ Ancillary insurance intermediary is determined also in the directive IDD; such intermediary can mediate the insurance only as his ancillary activity. Permission to do such intermediary can be gained only by the person concluding insurances covering the risks related to goods sale and services provided in the frame of his main business (including life insurance and liability insurance). Such permission cannot be granted to the institutions offering credits and persons under MiFID directive.

¹¹ In case of ancillary insurance intermediary, such person can be registered as such, who is already registered but as representing a different subject.

European regulations regarding the distribution of insurance products (IDD, PRIIPs, MiFID)¹² become a significant problem in connection with information being provided with to the consumers. This information should help the insurance companies' clients to make better decisions.¹³ Unfortunately, duties to inform have not been harmonised, thus insurance companies or insurance distributors will be abided by both mentioned regulations (IDD, PRIIPs, MiFID) and Solvency II.

The second actual problem is personal data protection. The relationship between the client (data subjects) and insurance company or intermediary is abided by many legal regulations. In many cases, it is necessary to apply more of them at the same time in a way not to have them mutually collided. When fulfilling duties resulting from personal data protection by GDPR, requests resulting from financial services regulation has to be taken into consideration, too. It means that insurance intermediaries have to follow new conditions of GDPR, as well.

3 Conclusion

In connection with the implementation of legislative changes, many key problems appear in the Czech insurance market (and not only there). The aim of those changes is to protect the client, to regulate intermediary activities in the insurance industry by determined requests set to enter this field, further it is the increase of market transparency, removal of differences in external and internal insurance distribution, and strengthening of insurance distributor (both internal and external).

Those change also influence the construction of insurance products and the way of their sale, as well as the intermediary activity. The segment of insurance distribution is also significantly influenced by new technologies being used at insurance distribution, new ways in the care of the client are implemented related to a digital age, preferences of current clients or "digital clients" occur. The actual problems are: personal data protection and information obligation to the consumer.

The Directive IDD and in accordance with it also the bill harmonises the regulatory principles for employment (internal) and intermediary (external) way of insurance products distribution. It brings such expecting scope extension i.e. the option to conclude the insurance contract by the employees of the insurance companies. The aim is to protect the consumer (insurance applicant, insurer, insured), as well as the understandability and comparability of information about financial products,

¹² The Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs) ("PRIIPS Regulation") determines unified rules related to the form and content of the key information, so called standardised consumer-friendly information ("Key Information Document" KID).

¹³ Nesleha and Urbanovsky analyse the level of financial literacy in the field of life insurance products in their articles. Their analysis investigates whether customers of insurance companies are provided with sufficient amount of information related to the products they look for, or whether some important information is missing, and such clients have to search for it on their own.

as well as to increase the demands for professionalism of people acting in the insurance industry and not only there but through the entire financial market. There will also be a simplification of the categorisation of insurance intermediaries. Since the current register of insurance intermediaries does not reflect the factual situation of the insurance market (registering in more positions, non-active intermediaries), a new way of registration would help to clean out the market from non-active intermediaries.

References

- Annual report of the Ministry of Finance of the Czech Republic 2000, 2001, 2002, 2003.
- Bill of Act on insurance and reinsurance distribution.
- Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution.
- Ducháčková, E., Daňhel, J. *Pojistné trhy: změny v postavení pojišťovnictví v globální éře* [Insurance Markets: Changes in the Position of the Insurance Industry in the Global Era]. Prague: Professional Publishing, 2012. ISBN 978-80-7431-078-2.
- Hrabalová, E., Vávrová, E. and Přečková, L. Assessing the Impact of the Financial Crisis on Global Insurance Regulation. In: *European Financial Systems 2017*. Proceedings of the 14th International Scientific Conference. Brno: Masaryk University, 2017, part 1. ISBN 978-80-210-8609-8.
- Krügerová, M. Major Trends and Developments in the Insurance Markets. In: *International Conference on European Integration 2016*. Proceedings of the 3rd International Conference on European Integration. Ostrava: VŠB – Technical University of Ostrava, 2016. ISBN 978-80-248-3911-0.
- Krügerová, M. Analysis of Insurance Distribution on the Czech Insurance Market. In: *European Financial Systems 2017*. Proceedings of the 14th International Scientific Conference. Brno: Masaryk University, 2017. ISBN 978-80-210-8609-8.
- Mesršmid, J. *Regulace pojišťovnictví v EU* [Insurance Regulation in the EU]. Praha: Professional Publishing, 2015. ISBN 978-80-7431-146-8.
- Nesleha, J. and Urbanovsky, K. Study of Financial Literacy in the Field of Insurance Products. In: *European Financial Systems 2016*. Proceedings of the 13th International Scientific Conference. Brno: Masaryk University, 2016. ISBN 978-80-210-8308-0.
- Vávrová, E. Assessing the Progress of the Implementation of the Solvency II Regulation. In: *European Financial Systems 2013*. Proceedings of the 10th International Scientific Conference. Brno: Masaryk University, 2013. ISBN 978-80-210-6294-8.
- Vávrová, E. and Nečas, S. The Evaluation of Financial Health of the Insurance Sector in the World's Insurance Centers. In: *European Financial Systems 2016*. Proceedings of the 13th International Scientific Conference. Brno: Masaryk University, 2016. ISBN 978-80-210-8308-0.
- cnb.cz. [online]. 2018. The Czech National Bank. Regulated institutions and registered financial market entities lists. Time series. Available at: https://apl.cnb.cz/apljerrsdad/JERRS.WEB07.INTRO_PAGE?p_lang=en [Accessed 13 Sept. 2019].
- czso.cz. [online]. 2005. The Czech Statistical Office.