

Online survey in preparation of the Call for Advice from the European Commission on the delegated acts under the Insurance Distribution Directive

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Product oversight and governance arrangements

Q1: Article 25(1)(1) IDD requires insurance undertakings and intermediaries which manufacture insurance products for sale to customers to establish specific organisational arrangements and procedures for the approval of each insurance product. From your point of view, under which circumstances should the activities of an entity (in particular of an intermediaries) be considered as manufacturing of insurance products? Could you provide examples of specific activities which you would consider as manufacturing?

Manufacturer means an insurance undertaking and an insurance intermediary that develops insurance products for the sale to customers and offers risk coverage at long term by these insurance products.

The manufacturer must ensure that relevant personnel involved in designing products should possess the necessary skills, knowledge and expertise in order to properly understand the product's main features and characteristics as well as the interests, objectives and characteristics of the target market.

A manufacturer has to carry out product analysis (product testing and product monitoring) and has to identify appropriate target markets. Product reviews are aimed at checking if the product performance may lead to customer detriment and, in case this occurs, take actions to change its characteristics and minimize the detriment.

Q2: If more than one entity is involved in the manufacturing of insurance products, how should the responsibilities of the respective entities be defined and distinguished? Should the entities be obliged to lay down their respective responsibilities in a written agreement?

Yes, there should be a written document which lays down the respective responsibilities of the involved entities. Additionally each company should be obliged to create the function of a product manager, who is responsible for the implementation of this document and for the information of all relevant staff members about it. Usually product managers are already responsible for the development and for the launch of new products.

Q3: According to Article 25(1)(3) IDD, the product approval process should specify an identified target market for each product and shall ensure that the intended distribution strategy is consistent with the identified target market. From your point of view, which are the essential factors and criteria to identify the target market? How should the target market be understood in the context of insurance products

which are supposed to be distributed to the mass market? Should there be different levels of granularity, e.g. depending on the complexity of the insurance product?

The essential factors and criteria in order to identify the target markets must exactly be those which are necessary to give best advice on the basis of a fair and personal analysis: age, gender, family status, professional status, income, property, assets, credit commitments. These are the main characteristics of any mass market for insurance products. As insurance products have very different levels of complexity, there must be different levels of granularity for the analysis of possible target markets. This is particularly important for “packaged” insurance-based investment products (PRIIPs), which include very complex risk-reward relations, return probabilities and cost structures.

Q4: According to Article 25(1)(2) IDD, the product approval process should be proportionate and appropriate to the nature of the products. Would you consider it appropriate and necessary requiring manufacturers to ensure that the insurance products are fairly priced and offer added value to customers?

Yes, it is appropriate and necessary that following to nature of the products the product approval process shall specify an identified target market for each product and assess all relevant risks to such identified target market. Complex insurance-based investment products, but which are offered in a standardized form (like possibly the future Pan-European Personal Pension products - PEPP), may follow a simplified product approval process. Consumer detriment can only be prohibited if insurance undertakings regularly review the insurance products they offer, taking into account any event that could materially affect the potential risk to the identified target market. Product testing and product monitoring must aim at guaranteeing a fair price. Any contract proposed shall be consistent with the customer’s insurance demands and needs. Therefore added value to customer can only be guaranteed by best advice on a fair and personal analysis, which must guarantee an effective risk coverage for each policy holder (e.g. no overlap of coverage, neither underinsurance nor over-insurance).

Q5: Which information should the manufacturer of insurance products make available to distributors (as required in Article 25(1)(5), IDD)? Should the manufacturer inform the distributors about the fair value of the insurance products, in particular with regard to insurance-based investment products?

The manufacturer should provide information on the main characteristics of the products, its risks and costs as well as circumstances which may cause a conflict of interests at the detriment of the customer. This information must be of an adequate standard, which is clear, precise and up-to-date. It is evident that the fair price of the product has to be part of this information, because the price - better the premium - is one of the main criteria for consumers for an informed purchase decision. The information given to distributors must be sufficient to enable them to:

- understand and place the product properly on the target market,
- identify the target market for which the product is designed and also

to identify the group of customers for whom the product is considered likely not to meet their interests, objectives and characteristics.

For PRIIPs it is particularly important to make scenario analysis by product testing and to monitor on an on-going basis during the life-cycle of a product any possible or actual factors and circumstances which may give rise to the risk of consumer detriment (especially risk-reward-profiles, performance scenarios and cost disclosures, which will be mandatory parts of the future KIDs).

Q6: Which arrangements should the distributor have in place to obtain all relevant information on the insurance product and the product approval process? What should be the consequence if the distributor does not obtain all necessary information?

The distributors should set out the product distribution arrangements in a written document and make it available to their relevant staff. They have to establish a proper management of conflicts of interests and must ensure that the objectives, interests and characteristics of customers are duly taken into account (cf. preparatory POG Guidelines 1 and 2 for distributors by EIOPA, October 2015).

Additionally each company (except sole traders) should be obliged to create the function of a distribution manager, who is responsible for the implementation of the unique written document and for the information of all relevant staff members about it. These distribution managers would have the same tasks as product managers, who are already responsible for the development and for the launch of new products by the manufacturers (cf. our comments on POG Guidelines 1 and 3 for manufacturers, January 2015).

If there is the potential or even actual risk of consumer detriment due to lack of information on product testing or product monitoring by the product manufacturer, the distributor has to change its distribution strategy immediately. The identified target market has to be reassessed and this information (including the reasons why) has to be given to the manufacturer. If still the distributor does not obtain all necessary information from the manufacturer, the distribution of this product has to be stopped immediately, and the distributor must be obliged to inform the National Competent Authority.

Q7: According to Article 25(4), IDD the insurance undertaking shall regularly review the insurance products it offers and markets. From your point of view, what are the essential elements of this review, in particular with regard to insurance-based investment products?

The review of insurance products by the responsible undertaking should encompass the entire procedure of designing, testing and monitoring of the products during their life-cycle. This means particularly:

- identifying a target market for which the product is considered appropriate;
- identifying market segments for which the product is not considered appropriate;
- carrying out product analysis to assess the expected product

performance in different stressed scenarios;

- carrying out product reviews to check if the product performance may lead to customer detriment and, in case this occurs, take actions to change its characteristics and minimize the detriment;
- identifying the relevant distribution channels taking into account the characteristics of the target market and of the product; and
- verifying that distribution channels act in compliance with the manufacturer's product oversight and governance arrangements.

Additionally this review must encompass the different Key Information Documents for PRIIPs and for all the other non-life products. Related to PRIIPs especially all factors related to risk-reward-profiles, performance scenarios and cost disclosures, which still have to be definitively fixed in the context of the PRIIPs regulation, will have to be taken into account.

Conflicts of interests and inducements

Q8: According to Article 29(2), IDD, monetary and non-monetary benefits which are provided in connection with the distribution of an insurance-based investment product or an ancillary service should not have a "detrimental impact" on the quality of the relevant service to the customer. From your point of view, which criteria and methodology should be applied to assess whether a benefit has a detrimental impact on the quality of the service?

First we stress that we fully agree upon the fundamental objectives for any conflicts of interest policy, which are exposed in the EIOPA Technical Advice on "Conflict of Interest in direct and intermediated sales of insurance-based investment products", published on 30 January 2015 (cf. "Procedures to be followed and measures to be adopted", point 4.3.3, p. 12 and 13).

In order to assess whether a benefit has a detrimental impact on the quality of the service or not, in our point of view there is one decisive criterion: the best advice on the basis of a fair and personal analysis (cf. recitals 44 and 45 of IDD).

Benefit of consumer will be fostered most effectively, if the distribution remuneration mechanisms shift from "quick sale" to long-term customer relationship. In insurance business, it should become obligatory to measure success in sales by how long-term the policy holders will be tied to the contract. Although high acquisition commissions and incentives may guarantee success in the short term, they are also very costly. The objective should be to allow insurance intermediaries to participate in the success or failure of the insurance contracts they have brokered.

Q9: Please provide specific examples and cases where you would consider that benefits have a detrimental impact on the quality of service?

In our comment on Q4 of EIOPA consultation on conflicts of interest in July 2014 we have elucidated some examples of mis-selling cases. This is one of them: Life insurance contracts which promise a life annuity are calculated following to mortality tables recommended by the professional association of actuaries. But there is no legal obligation to follow this recommendation, the

insurer is free to change the "Rentenfaktor" and fix it only at the very beginning of the annuity payments (in case, the contract has not fixed any mandatory parameters of calculation of annuity payments in relation to premiums paid). The result is that reducing the annuity payments, the customers have to wait at least for 25 years or even for 30 years, until the sum of the pension payments by the insurer is equal to the sum of premiums once paid. This waiting period exceeds largely the average life expectancy for men and women in Germany, and so there is no doubt about who makes the profit..

Following to the Life Insurance Reform Act ("Lebensversicherungsreformgesetz") of

Summer 2014, some German life insurers started changing their commission systems. Less commission will be paid at the point of sale ("Abschlussprovision"), more commission will be paid related to the duration of the contract ("Bestandsprovision").

From a consumer's perspective we approve these changes, because they are - at least - a first step of the quality enhancement criterion exposed by MIFID. This criterion can only be implemented if services which are necessary for the maintenance of the contract by the customer are remunerated on a much higher level (such as adjustments of the personal situation of the insured, advice for damage report etc.).

By these new remuneration mechanisms only those intermediaries will gain who succeed in maintaining a long-term customer relationship by "helping and supporting". Focusing only on quick sale would be punished on the contrary. At least the period, in which large parts of the acquisition commission have to be paid back in case of cancellation of the contract ("Stornohaftungszeit"), has to be prolonged from five to ten years.

In the long term we strongly advocate the abolishment of any entry fees or sales commissions. They should be included in administrative commissions over the lifespan of the contract. The total sum of commissions for sale and contract administration should clearly be reduced.

Q10: Are there any specific types of benefits which have detrimental impact on the quality of the service already by their nature (e.g. tickets for sports events or training classes at exotic destinations)?

Excessive sales targets, sales pressure, sales contests, performance measurement systems, sales incentives and after-sale transactions (like cruise ship travels) as well as "churning" in order to generate commissions (e.g. excessive switching of funds) are specific types of benefits, which have strong detrimental impact on the quality of the service already by their nature. This enumeration is of course not exhaustive.

Besides the disclosure of the benefits for the intermediary at the point of sale, additional benefits for other distributors linked to him on the upper hierarchy (like the director of the distribution company e.g.) should be included, too.

Q11: Are there any models for calculating benefits or payment methods which you would consider detrimental on the quality of service?

Third party payments or benefits are one major source for mis-selling cases. Especially in Germany the insurance distribution still depends nearly completely on "hidden" commissions (calculated by the Zillmerisation Method). If commissions are not disclosed, the consumers are taken to believe that the sales activity is for free. Of course this would only be the case, if consumers do not conclude any contract. Under these circumstances it is evident, why distributors always try to sell any kind of contract, even if it is completely non- appropriate for the customers.

Q12: Please provide specific examples and cases where you would consider that any risk of detrimental impact on the quality of service can be excluded?

In our comment on Question 4 of EIOPA consultations on conflicts of interest in July 2014 we have elucidated some strong examples of mis-selling cases. Taking into consideration the variety of these cases, we would like to stress that there is no "egg of Columbus" against mis-selling practices. Mis-selling practices can only be reduced by permanent and detailed analysis of distribution practices and by strictly applying a bundle of different severe counter-measures. Some of these measures have already been pointed out (cf. our comments on Questions 9, 10 and 14 of EIOPA consultation in July 2014 and on Questions 11 and 12 of EIOPA consultation in December 2014):

"Hard" disclosure of any kind of third party payments and inducement related to insurance PRIPs has to be mandatory. The disclosure should not only include commissions for the pure sales activities, but for the long-term administrative activities, too.

Hard disclosure of commissions and strict implementation of compliance rules (POG Guidelines etc.) by insurer boards may entail a more or less strong reduction of numbers of distributors. From the point of view of consumer protection such a development may even reinforce fairness in selling practices. Regular appropriate income represents a main objective in order to reduce "push sales" and to strengthen "best advice" by distributors.

But as a consumer organization we do not only stress the necessity of changes in the current commission remuneration system, but there has to be developed a level

playing field among different types of remuneration systems including a fee based

system. This is especially the case for the financial services in Germany, where the so-called "Honorarberatung" (a fee based advice - no sale of any product) was - until now - completely overridden by the existing commission system. Only full transparency of any kind of commissions, inducements, incentives or fees will allow the customers to make an informed investment decision.

Q13: From your point of view, under which circumstances do insurance intermediaries and insurance undertaking not comply with their duty to act honestly, fairly and professionally in accordance with the best interests of the customers when receiving or paying inducements (not having a detrimental impact on the quality of the service) as laid down in Article 29(2)(b), IDD?

One major problem driver which has to be taken into consideration is the choice of qualified personal. Knowledge and ability requirements have to be standardized on a common mandatory level, a continuous professional development (CPD) has to be implemented by each insurer. When choosing new personal, distributors or insurers have to stress that working for a financial company does not mean "quick sale" and "making a big fortune" only in a short time. Insurers very often assert that insurances are products that have to be pro-actively "sold", because they are an "abstract" product, not like a TV, a computer or a car which are obviously "haptic". From the consumers perspective we clearly object this assertion. Consumers know their life risks exactly, but they do not know the appropriate insurance products covering these risks. So, the sales pressure on the one hand and the lack of technical knowledge on the other hand lead to a kind of "vicious circle" between intermediaries and customers. The only way out of this constellation producing all the mis-selling cases we know consist in implementing strict compliance rules for the distribution. Unconditional priority has to be given to best advice as a service in itself (and not just as a supplementary argument of sale) and consequently to the social responsibility of the insurers. As Mr. Bernardino stressed recently: "We expect leadership; a tone from the top. It is the Board responsibility to make sure that adequate product oversight and governance is established within the undertaking" (Speech in Reykjavik, 27 June 2014).

Q14: Which steps should insurance intermediaries and insurance undertakings be supposed to take in order to address and manage conflicts of interest resulting from inducements?

Conflicts of interest have to be considered as part of Business Conduct Risks. These are risks relating to the way in which a firm and its staff conduct themselves, and includes matters such as how consumers are treated, how products are designed and brought to market, remuneration of staff, and how firms deal with conflicts of interest or resolve similarly adverse incentives. With respect to the conduct of business, there is a link between conduct risk and governance. To make it clear from the outset: any kind of inducement which would not be for the benefit of the customer must be forbidden and sanctioned. In its Delegated Act on Solvency II (2015/35/EU by 10 October 2014) the European Commission developed a System of Governance (Chapter IX), in which "Fit and Proper Requirements" for the management as well as principles of Remuneration Policy are fixed. Article 275 states that "...the remuneration policy and remuneration practices shall be established, implemented and maintained in line with ... the long-term interests and performance of the undertaking as a whole and shall incorporate measures aimed at avoiding conflicts of interest; (...) there shall be clear, transparent and effective governance with regard to remuneration, including the oversight of the remuneration policy". Part 2 of the same article underlines that "...where remuneration schemes include both fixed and variable components, such components shall be balanced

so that the fixed or guaranteed component represents a sufficiently high proportion of the total remuneration to avoid employees being overly dependent on the variable components and to allow the undertaking to operate a fully flexible bonus policy, including the possibility of paying no variable component".

As a consumer organization we fully agree with these principles and we emphasize their relation with the "fit and proper" requirements: "assessment of the person's

professional and formal qualifications, knowledge and relevant experience within the insurance sector" as well as "assessment of that person's honesty and financial

soundness based on evidence regarding their character, personal behavior and business conduct including any criminal, financial and supervisory aspects relevant for the purposes of the assessment" (article 273). Additionally we stress that corporate governance, risk management and internal audit function have to be separated clearly.

Assessment of suitability and appropriateness

Q15: From your point of view, what are the relevant criteria to assess whether an insurance-based investment product is suitable for a customer pursuant to Article 30(1), IDD?

From the consumer's perspective there is a clear priority related to insurances: risk coverage is more important than savings. This priority is even more important in relation to life insurances. With the exception for persons who live as singles, only term life insurances for spouses and families with children have to be considered as a necessary risk coverage. Related to the risk of longevity, annuity insurances are one possible option, but for retirement provision the whole spectrum of securities and other pension plans are relevant options, too.

Life insurances with profits have to be considered as secondary insurances classes, because there are neither transparent nor cost-efficient as long-term saving instruments. In Germany (with more than 80 million capital life insurance contracts) far more than 50% of these contracts are cancelled before reaching maturity (cf. our comment on Q19 of JDP on KIDs for PRIIPs in February 2015).

As already pointed out in our comment for Q3 of this consultation, the relevant criteria for a fair and personal analysis are as follows: age, gender, family status, professional status, income, property, assets, credit commitments. Additionally on our website our organization offers a free online tool for the fundamental analysis of needs of each policy holder

("Bedarfs-Check"):

<https://www.bunddersicherten.de/BedarfsCheck>

Q16: What is your understanding of risk tolerance and ability to bear losses in the context of Article 30(1), IDD?

Related to PRIIPs the most important risk of consumer detriment consist in cancelling the contract before reaching maturity. In these cases no capital guarantees are valid, and additional strong penalty fees heavily reduce the accumulated savings of the customer being paid out.

So prior to the analysis of risk tolerance and ability to bear losses as it is usually done by investment companies when selling securities (in Germany following to article 31, paragraph 4 of Securities Trading Act / Wertpapierhandelsgesetz), the best advice on the basis of a fair and personal analysis of risk coverage has to be given (cf. our comments on Q3 and Q15). Additionally we would like to underline that probably the understanding of risk tolerance and ability to bear losses strongly differs between the EU Members States depending on the quantity and the degree to which the population has direct and proper experiences in retail investments. In Germany this is called "Aktienkultur".

Q17: From your point of view, what are the relevant criteria to assess whether an insurance-based investment product is appropriate for a customer pursuant to Article 30(2), IDD?

The relevant criteria in order to assess the appropriateness of a PRIIP must exactly be those which are necessary to give best advice on the basis of a fair and personal analysis: age, gender, family status, professional status, income, property, assets, credit commitments (cf. our comment on Q15). Additionally the mandatory disclosures of complex risk-reward relations, realistic return probabilities and comprehensive cost structures (by the PRIIPs Key Information Documents) must be explained by the distributor. By doing so, the distributor will be able to assess whether the customer is able to fully understand the offered product following to the customer's knowledge and experience in the investment field. If the customer is not able to make a clearly informed investment decision, the mandatory warning of the possible detrimental effects must be given in a written document.

Where a bundle of services and products is offered, the appropriate advice given by the distributor must prevent from selling any kind of overlap of coverage, of underinsurance or over-insurance.

Q18: What are the relevant criteria to identify non-complex insurance-based investment product (as referred to in Article 30(3)(a)(ii), IDD)? Which insurance-based investment products would you consider as non-complex?

First we would like to stress that from our perspective there are no non-complex insurance based investment products. Any kind of life or annuity insurances are a "packaged" product, because they include an investment part of the premium (either in an unit-linked product or in a classical with-profit product) additionally to the risk coverage.

Even if the complexity of the product itself cannot be reduced, efforts must be made in order to enhance the transparency of the product. Transparency is essential and necessary for the customer in order to enable a fully informed investment decision. More transparency can only be achieved by the mandatory disclosures of actual risk-reward relations, of realistic return probabilities

and of comprehensive cost structures as foreseen by the forthcoming PRIIPs Key Information Documents.

Only related to classical capital life-insurance contracts, where the customer cannot choose the investment strategy and therefore the insurers guarantees an interest rate on the investment part of the premium, the individual knowledge and experience of the customer related to investment strategies is not directly relevant. Instead of this, the comprehensive disclosure of costs which strongly reduce the investment part of the premium is all the more necessary. As already pointed out in Q16, in these cases the most important risk of consumer detriment consist in cancelling the contract before reaching maturity: no capital guarantees are valid, and additional high penalty fees heavily reduce the accumulated savings of the customer being paid out.

Reporting

Q19: Apart from the insurance contract (Article 30(3), IDD), the suitability statement (Article 30(4), IDD) and the periodic reports (Article 30(4), IDD), what information should the distributor be required to record?

The additional information the distributor should be required to record is linked to IDD article 27 (prevention of conflicts of interests), article 28 (conflicts of interest) and article 29 (information to customers):

- which organizational and administrative arrangements have been implemented in order to identify, to prevent and to manage conflicts of interest;
 - if advice had been given on basis of a fair and personal analysis (difference between a “suitable” and a “best” advice and the possible consequences for the analysis of his individual financial conditions);
 - if the customer got the information that he may request an itemized breakdown of the costs and charges (“soft” disclosure of all costs and charges, including any commissions or other inducements by third parties).
- For the information to be given in the record after contract conclusion, cf. our comment to Q 20.

Q20: What is the relevant information which should be included in the insurance contract (Article 30(3), IDD), the suitability statement (Article 30(4), IDD) and the periodic reports (Article 30(4), IDD)?

The insurance contract must include the complete terms and conditions of the contract itself. It must be completed by the Key Information Document (cf. IDD article 20 paragraph 8 for non-life contracts). Following to the German law (provision on information duties of insurance contracts: VVG-InfoV – Verordnung über Informationspflichten bei Versicherungsverträgen, article 2) life insurance contracts must include these information:

- Amount of calculated costs included in the premium;
- Total amount of entry cost (in absolute figures);
- Ongoing administrative and other costs as percentage of annual premium;

- With profit mechanism;
- Probable development of surrender values (in absolute figures);
- Promised capital guarantees and related interest rates;
- Conditions for exemption from or at least reduction of payment of premiums (in absolute figures);
- Possible choice of funds (in case of unit-linked contracts);
- Relevant tax provisions;
- Insured loss and risk coverage.

We recommend these concise parameters for the future RTS of IDD. Of course all these parameters and their developments should mandatorily be part the periodic reports by the insurer.

For the suitability statement we refer to our comment on Q16 and to the German Securities Trading Act (Wertpapierhandelsgesetz, article 31, mainly paragraph 4), in which the analysis of the risk tolerance and of the ability to bear losses by the retail investor is fixed.

Q21: At what frequency should periodic reports (Article 30(4), IDD) be provided to the customers and what information at a minimum should be contained in the reports?

Following to the German law (provision of mandatory information on insurance contracts: VVG-InfoV - Verordnung über Informationspflichten bei Versicherungsverträgen, article 6, paragraph 1, subparagraph 3) life insurers usually have to provide information during the duration of the contract once in a year. The minimum information to be provided are the ongoing developments of surrender and maturity values and any changes of the other relevant parameters pointed out in Q20.

Related to non-life contracts we refer to IDD article 20 paragraph 8 (information contained in the future product information document): at a minimum any change of terms and conditions mentioned under this article should be contained.

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