

**Comments Template on
DP-14-IMD
Discussion Paper on
Conflicts of Interest in
direct and intermediated sales of
insurance-based investment products (PRIIPs)**

**Deadline
22 July 2014
18:00 CET**

Name of Company:	BdV	
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Reference	Comment	
General Comment	<p>As Germany's most important <i>NGO</i> of consumer protection related to private insurances (with more than 50.000 members), we strongly support EIOPA's position that consumer protection "will remain EIOPA's strategic goal number one", as Mr. Bernardino said in his keynote speech at July 11th in Frankfurt/Main.</p>	

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	<p>We would like to thank very much for the opportunity to participate at the EIOPA <i>conference</i> that day on "Conflicts of interest related to insurance distribution activities". Additionally the <i>Discussion Paper</i> published by EIOPA at 21 May 2014 related to this consultation was very detailed. Both were heavily inspiring for the written answers being presented here.</p>	
Q1.	<p><i>Best advice versus quick sale:</i> Consumers need comprehensive risk coverage and therefore independent and impartial, "<i>best</i>" <i>advice</i> (including complete analysis of their personal and professional situation). Intermediaries often offer just <i>suitable</i>, sometimes only <i>poor</i> advice (due to lack of time and desire of "<i>quick sale</i>"). Disclosure of professional status as independent or tied agent and its impact on the offered range of contracts are essential for choice by consumers.</p> <p><i>Fair premiums versus increase of sales volumes/sales pressure:</i> consumers are ready to pay <i>fair premiums</i> with only reduced capital loss risks. Independent agents are obliged to strive for constant increase of <i>sales volumes</i>, and employees of insurers and banks are often submitted to strong <i>sales pressure</i>. The risk of high capital loss for consumers, if the life insurance contract is cancelled more or less shortly after its conclusion, increases even more under these conditions.</p> <p><i>Transparency versus information overload:</i> consumers seek to understand what they intend to buy. Therefore they need <i>transparency</i></p>	

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of contract clauses. But at the point of sale they are confronted with *information overload* on contract conditions and details, which produces even more confusion (concerning mechanisms of participation of benefits, pre-contractual information duties, obligations of claims settlements etc.). Therefore any jargon and *unnecessary technical terms* have to be avoided. The information should be reduced to only those facts that are related to the given product and should not include any additional information related to other products.

Simple products versus complex products: In order to meet their fundamental needs consumers look for *simple* products. Insurers develop *complex* products in order to avoid transparency on scope of cover, on participation of benefits, on capital loss risks, on costs of contract etc. Insurance PRIIPs (PRIIPs) are on the top of complex products. Therefore we suggest offering complex products only to those customers who are experienced with complex financial products.

Q2. The needs of the consumers are evident: they need a comprehensive risk coverage for a fair price. An insurance is not a "normal" consumer good like a TV, a computer or a washing machine, because an insurance contract has to cover *fundamental life risks* like loss of property (house, content, car etc.), liability (protection against third party claims) or illness, disability or even death. In some very important issues like health insurances, life insurances or pension schemes it is likely that customers never acquire solid experiences, because they buy those

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products only once or twice in their whole life. These are the reasons why the purely commercial sales interests of the distributors have to be tamed on a legitimate level. The full disclosure of *remuneration mechanisms* with a priority to the disclosure of commissions (“hard disclosure”) should therefore be transferred from the banking sector to the insurance sector, especially when linked to insurance PRIIPs.

Surveys assess again and again the - more or less - *poor financial education* and knowledge of the majority of the population in the EU member states. This assessment meets the overwhelming, sometimes exorbitant desire for commercial success. Complex products are one of the major means for the realization of this desire. A decisive measure as a way out of this *asymmetry of information* is the development of *key information documents (KIDs)*. These KIDs have to be *standardized* in shape, print and parameters for each product category, which should be one of the main goals of European supervisory activities. Plain language, standardized information on risks and costs should become mandatory.

Q3.

In the general public debate on *fair* sales practices, the *responsibility* not only of the distributors (brokers, agents or any other kind of intermediaries like in Germany the so-called “Strukturvertriebe”- multi level distribution companies), but also the responsibility of the insurers themselves should be stressed much more clearly. Sole distributors are often even a victim of remuneration and inducement systems, in which

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they cannot make anything else but “quick sale”. Additionally any kind of *soft commissions* (like corporate hospitality and gifts, soft loans, training support, administrative support) that intermediaries receive from insurers should be disclosed on their websites and be part of written protocols of the sales process (like in Germany the “Beratungsprotokolle”).

The responsibility for these remuneration and inducement systems which focus exclusively on the constant increase of sales volumes lies on the *directors of distribution services* in insurance companies. Therefore the supervisory authorities should implement strict *compliance rules* for reformed remuneration and inducement mechanisms which give priority to long-term customers advice and services.

Q4.

In Germany three strong examples of conflicts of interest can be given which are directly linked to the problem of complex products: 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

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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...

In October 2012 one of the most important German economic newspapers, the Handelsblatt, published a large report on mis-selling practices by the life insurer ERGO. It was reported that there were more than 5000 cases of mis-selling practices in only a few months. Agents of ERGO pushed customers to exchange their life insurance contracts to accident insurance contracts with much lower interest rates ("Umdeckungen").

In the sector of *illness insurance* for many years there was the problem of low budget tariffs especially for young people. High increases of these premiums after some years were inevitable, and affected costumers tried to change these tariffs. But even if there is the legal obligation to offer a different tariff by the same insurer, there are lots of cases in which insurers tried to prevent any change of tariff.

Q5.

Life insurance contracts are not only saving contracts but contracts linked to basic *risk coverage* (mainly disability or death risks). This is true for insurance PRIIPs, too. This is the reason why all requirements exposed above on *transparency* (versus information overload) and on *simple products* (versus complex products) have to be added here

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	(mainly on participation of benefits and on actuarial parameters).	
Q6.	As said above PRIIPs are <i>insurance</i> contracts, not just saving contracts. Therefore customers need a <i>comprehensive analysis</i> of their personal and professional <i>risk coverage</i> . Any additional insurance should fill a possible gap in the risk coverage, the premiums of the contract should be appropriate, customers have to get <i>value for money</i> (best advice, not quick sale).	
Q7.	The German <i>Federal Court of Justice</i> (Bundesgerichtshof-BGH) published only recently a new judgment on the mandatory disclosure on so-called internal commissions of banks (BGH: XI ZR 147/12). This judgment is a supplement to the already existing jurisdiction on kick-backs. Following the requirement of full disclosure of all costs and payments mechanisms (“flächendeckendes Transparenzgebot” following to the BGH) this jurisdiction should be fully applied to insurance PRIIPs.	
Q8.	One result of the debates held at the EIOPA conference on conflicts of interest in Frankfurt at July 11 th was that representatives of small or sole insurance intermediaries expressed clearly their fears about this question. They fear that if the measures listed in Article 22 of MIFID will have to be fully implemented, the number of small and sole insurance intermediaries will strongly be reduced. This might even be in the interest of some big insurers which strive to have only a few but powerful distribution channels. Simultaneously the number of medium	

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sized insurers, which use only independent brokers as their distribution channel, will surely be reduced as well.

This prognosis may fulfill. But for the purpose of consumer protection the commitment of best advice and of fair price must preserve the unquestionable priority. There is a high risk of harm to the interests of consumers, if the measures of managing conflicts of interest are softened for any kind of intermediaries. Just the question, how to draw the quantitative limit of small intermediaries which will not have to follow these measures, will always be considered as arbitrarily.

A solution could emerge, if complex insurance PRIIPs are restricted to be sold only to experienced customers. Then even small intermediaries will probably have good business chances as distributors for particular customer groups ("Nischenanbieter") through specialization for those complex products.

Q9.

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. 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.

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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.

Two conclusions should be drawn from the current situation: "hard" disclosure of any kind of third party payments and inducement related to insurance PRIIPs has to be mandatory. The disclosure should not only include commissions for the pure sales activities, but for the long-term administrative activities, too. Otherwise there is the real danger that parts of the sales commissions will simply be transferred to administrative commissions by the insurers. This problem has not been solved recently in the German "Lebensversicherungs-Reformgesetz".

Q10.

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 leads to a kind of "vicious circle" between intermediaries and customers.

The only way out of this constellation producing all the mis-selling cases

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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).

We also would like to emphasize that often "new" products are so complex that even the intermediaries have not got any idea about how they function. Allianz introduced last year a new product ("Perspektive") related to which even the spokesman assessed that it would be a product without the classical guaranteed interest rate for the investment component. The intermediaries got that same information, too. But this information was wrong. There is a guaranteed interest rate, but it is strongly reduced for most of the duration of the contract. This example shows that even the normal intermediaries have huge problems with those complex products. Therefore we recommend differentiated measures for complex products.

Q11.

The British parameter for increase in value of life insurances is "Reduction in Yield". The "RiY" will now be introduced even in Germany as "Effektivkosten". This is not a step maximizing disclosure but confusion. Following to "RiY" the costs of a contract reduce the future

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gains foreseen by the insurer. But this is a parameter only on the basis of a certain *probability*. Gains are only probable, at the time premiums and costs are definitively *fixed*.

In order to maximize the understanding of the customers, the costs of a contract, especially linked to PRIIPs as very complex products, should always be calculated in relation to the premiums paid by the customers. Customers know exactly the amount of premiums they will have to pay regularly. They are able to calculate any possible yield (the sum of payments they will receive) in relation to the premiums they will have or they had had to pay. That is the reason why "RIY" is a mis-leading parameter and should be banned.

Additionally RiY is a very volatile key number related to the duration of the contract, to the duration of payment of premiums and to the pre-cost rates ("Zins vor Kosten"). Because of these complex mathematical interdependencies it is possible to pretend having a "cheap" product by altering these parameters, although the product is very expensive.

Q12.

In Germany there exist huge distribution organizations (multi level or subscriber broker structures: "Strukturvertriebe"), in which sole distributors are "independent" on the juridical level, but in reality of course not. They have to sell only product lines chosen by their home organization, and sometimes they even have to pay a rent for their bureaus and for the technical equipments to their "mother company".

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	<p>Following to the German law this situation is called "Schein-Selbständigkeit". In this context nothing but extreme sales pressure and therefore mis-selling are the inevitable consequences. The entire structures of these systems of distribution and remuneration have to change from the ground up (fixed incomes following trade union standards, variable remunerations and inducements only as volunteer "bonus").</p>	
Q13.	<p>Yes, these already existing measures should fully be applied to insurance distribution activities, because insurance PRIPs consist of insurance <i>and</i> of investment components. This should include the level playing field, too.</p> <p>Following to MIFID article 24 (2) <i>marketing communication</i> has clearly to be identified as such. One of the strongest marketing arguments of life insurances are any kind of promised guarantees. Insurance consumers often prefer guarantees to high yields. That is reason why it is absolutely necessary that, if any kind of guarantee is promised by the insurer, the conditions under which this guarantee are given have to be fully disclosed and explained in detail (as a pre-contractual information duty included in KID).</p>	
Q14.	<p>One major problem driver which has to be taken into consideration is the choice of qualified personal. <i>Knowledge and ability requirements</i></p>	

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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.

On the contrary, distribution personal has to learn that the interests of the consumer are at the centre of the company's culture and strategies. Again, it is the *responsibility of the Board* to emphasize that trust and confidence by consumers is gained by doing business in a honest way, having good governance arrangements, and offering transparent products. We totally agree on this point with Mr. Bernardino.

Additionally we would like to stress that the more financial products are complex - like insurance PRIIPs - the more additional professional trainings are necessary. The objective that consumers are able to understand what they intend to buy can only be reached by the necessary prior step, that intermediaries understand what they sell. The implementation of these differentiated professional trainings belongs fully to the responsibility of the insurers. In 2008 the Florida Office of Financial Regulation obliged insurers to offer additional professional trainings only for selling variable annuities.

Q15. In recent years in Germany many efforts have been made - even by the legislator - to strengthen fee-based advice and distribution of financial

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products (“Honorarberatung”). As a consumer NGO we clearly support these efforts. This represents an important step to a larger consciousness of consumers (and distributors!) that *advice* is a necessary service and *insurance* must be the appropriate product.

Nevertheless the numbers of fee-based advisors specialized on insurances (“Versicherungsberater”) are still too small. Commission-based distribution will persist on a large scale very probably, but there has to be a *level playing field* between these two kinds of remuneration systems. The argument that “hidden” commissions are cheaper than fees is wrong and has to disappear. The more fee-based distribution is spread, the better is the chance that commission-based remuneration changes (from pure volume-based inducements to long-term services by continuous flow of remuneration).

Q16.

Due to tax privileges, for decades life insurances have reached a clearly dominant position in asset allocation of German retail savers (apart from house ownership). Instead of share holder education (“Aktienkultur”) there are more life insurance contracts than inhabitants in Germany (more than 90 millions of contracts).

But this does not mean that every German citizen has a life insurance contract. On the contrary, many customers do not have a single one, so others possess even several contracts. This implies very often that many customers have contracts with low premiums in each of them. It

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is obvious that the sum of premiums the customers have to pay regularly is rather high, but the structure of their contracts represents a tremendous driver of costs. This is nothing but the result of constant poor advice and represents an exorbitant mis-allocation of the savings of consumers.

One additional driver for costs lies in the assumptions for the calculation like mortality tables as mentioned above. They reduce the payments owed in a very specific way, although they are not costs. Because of the outrageous lack of transparency (it's normally not possible to know these tables for out-standings persons) they are a huge problem for consumers.

Q17.

Hard disclosure of commissions and strict implementation of compliance rules 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.

Mis-selling practices damage consumers with small or medium incomes even more: first they are the consumers group which is most pushed to conclude several life insurance contracts with low premiums in each. Secondly because of unstable professional biographies, these customers cancel their life insurance contracts most before reaching maturity. So,

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	<p>they do not only have the highest “hidden” costs, but they suffer from additional and real capital loss because of low surrender values (especially during the first years after conclusion of contract). In Germany more than two-third of life insurance contracts do not reach maturity.</p>	
Q18.	<p>The current system of “unitary premium” for life insurances is obsolete. In the traditional capital life insurance the asset allocation was made by the insurers themselves. Unpredictable stock markets and the current low interest phase reduced harshly the importance of these traditional life insurances with “guaranteed” interests. Like British and French insurers German life insurers now offer more and more unit-linked products and insurance PRIPs with either reduced or no guaranteed benefits at all. This implies that the risks of capital markets are <i>transferred</i> from the insurers to the customers.</p> <p>In order to be able to follow closely increase (or decrease) of the capital encapsulated in their life insurance contracts, the customers need more transparency. Instead of an “unitary premium” the premium has to be split up into three components: the risk component (part of premium linked to risk coverage mainly death and disability), the administration component (part of premium linked to costs of sale and of long-term administration and service), the capital component (part of premium which is invested as savings of the customers).</p>	

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The full disclosure of the capital component of life insurance contracts is the necessary condition for the assessment of capital value at any time by the customers. The total amount of capital assets of German life insurers (*without* particular occupational pension schemes like *Pensionskassen*) reached *793 million Euro* in December 2013 (BaFin Annual Report 2013, p. 132, table 20).

Again we would like to stress that the more financial products are complex - like insurance PRIIPs - the more it is necessary to prevent any harm from the needs of the customers that these consumer protection measures ought to be implemented.

Available statistics and reports:

Total amount of number of contracts, premium income and payments:

- Annual Reports of *BaFin* (German Financial Supervisory Authority).
- Statistical Yearbooks of the Association of German Insurers (*GDV*).

Reports on complaints-handling:

- Annual Report of *BaFin* 2013, part 5.4: Consumer complaints and enquiries.
- Annual Reports of *Versicherungsbundsmann* in Berlin (ombudsman of private insurances except of illness insurances, but inclusion of complaints about intermediaries).

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Former studies on mis-selling practices and standardized product information sheets in Germany:

- Stellungnahme des Bundes der Versicherten e. V. (BdV) für das Bundesministerium für Wirtschaft und Technologie (Berlin) vom 10.9.2012 (Aktenzeichen: IIB3 – 12 03 63) zum Vorschlag der Europäischen Kommission für eine Richtlinie des Europäischen Parlaments und des Rates über Versicherungsvermittlung – Neufassung (IMD 2).
- Transparenz von privaten Riester- und Basisrentenprodukten, Auftragnehmer: Zentrum für Europäische Wirtschaftsforschung GmbH, Mannheim Juni 2010 (für das Bundesministerium für Finanzen, Berlin).
- Anforderungen an Finanzvermittler. Mehr Qualität, bessere Entscheidungen. Studie im Auftrag des Bundesministeriums für Ernährung, Landwirtschaft und Verbraucherschutz, Berlin Dezember 2008.