

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:	Verbraucherzentrale Bundesverband e.V. (vzbv) / Federation of German Consumer Organisations	
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Reference	Comment	
General Comment		
Q1.		
Q2.	The most important type of conflict of interest we experienced in practice are remuneration/inducement-based conflicts as summarized under Art. 21 (e) of the Mifid 1 Implementing Directive. While other types of conflicts of interest certainly play a role in doing	

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	<p>harm to customers, remuneration/inducement-based conflicts are most important.</p> <p>To make a more general comment on the applicability of the Mifid 1 Level 2 provisions to insurance-based investment products, it should be taken into account that Mifid investor protection rules are designed to include (semi-) professional and retail investors. However, in contrast to investment products, insurance-based investment products do not address professional or semi-professional investors but are designed to address retail investors only. Accordingly, the provisions on conflicts of interest have to be amended to take into account of the specific problems retail investors face.</p> <p>This said, we suggest to introduce a quality criterion to the types of conflicts of interest listed in Art. 21 that clearly states that conflicts of interest related to remuneration or inducement are the most important with respect to potential harm to retail investors. This quality criterion should be introduced without respect to amendments adding additional categories or types of conflicts of interest to the existing list.</p> <p>We would like to note that our view on the particular importance of remuneration/inducement-based conflicts of interest has been backed up by the EIOPA fact-finding among NCAs as well as by the recent public EIOPA event on the IMD in Frankfurt.</p>	
Q3.	No, in our view, the CEIOPS 3L3 paper on possible amendments is exhaustive with respect to potential categories. It is more important to differentiate existing types of conflicts of with respect to the potential harm they may do to retail clients as implicitly done by Q2.	
Q4.		
Q5.	Yes we agree, referring to the CEIOPS 3L3 paper again. However, in our view, it appears even more important to differentiate existing types of conflicts of interest with respect to the potential harm they may do to retail clients. We outlined above that remuneration/inducement-based	

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	<p>conflicts of interest should have an outstanding position in any insurance-specific redraft of Art. 21 Mifid 1 Implementing Directive.</p> <p>However, this outstanding position must not be restricted to the IMD Level 2 but should simultaneously be part of the redraft of the Art. 21 Mifid Implementing Directive currently underway. We thus would like to encourage EIOPA to synchronize with ESMA's effort to account for the specific role that remuneration/inducement-based conflicts of interest play for retail investor protection.</p> <p>Beyond the differentiation of types of conflicts of interest with respect to the potential harm they may do to retail clients, we suggest to explicitly amend Art. 21 by the following types of conflicts of interest.</p> <ul style="list-style-type: none"> - Tying and bundling practices - Sales targets and remuneration linked to sales volumes - Soft commissions - Post-point of sale and contingent commissions 	
Q6.	<p>Yes. Article 21 (e) should be adjusted to include all forms of commissions and not only those that go beyond standard commissions. A distributional channel based on commissions (monetary or non-monetary) is inherently prone to conflicts of interest. In its current form, Article 21 (e) assumes that conflicts of interest (e.g. to sell unsuitable products for reasons of own monetary interest) arise only when inducements are higher than a product specific base-inducement. This is misleading as it only solves the incentive to sell a particular product. The incentive to sell any product remains. In more general terms, inducements are not compatible with investment advice but are a key characteristic of sales-oriented distributional channels.</p>	
Q7.		
Q8.		
Q9.	<p>Yes we agree. In particular, the role of disclosure of conflicts of interest arising out of third party</p>	

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payments or benefits, commission payments or remuneration should be clarified more carefully than done in the discussion paper. While the Commission mandate states that “disclosure is not a measure in itself to manage conflicts of interest”, EIOPA technical advice should make clear that (quantitative) disclosure (of inducements) actually is an effective way to prevent conflicts of interest to materialize.

It is a matter of fact that remuneration/inducement-based conflicts of interest can neither be prevented nor managed effectively without questioning the distributional channel itself. Moreover, it should be clear that detailed disclosure of inducements is a necessary (but not sufficient) prerequisite for fair competition between distributional channels prone to conflicts of interest and channels not prone to.

With respect to coherence between IMD and Mifid Level2 measures, the ESMA draft technical advice on disclosure of inducement (redraft of Art. 26 Mifid Implementing Directive) must be the starting point of any discussion about disclosure.

ESMA Consultation Paper, chapter 2.15 §7-9:

7. In relation to monetary payments and non-monetary benefits received from or paid to third parties, investment firms should disclose to the client the following information:

- i. prior to the provision of the relevant investment or ancillary service, the investment firm shall disclose to the client in a clear, comprehensive, accurate and understandable manner, the existence, nature and amount of the payment or non-monetary benefit concerned. Where the amount cannot be ascertained, the method of calculating that amount must be clearly disclosed to the client;*
- ii. where an investment firm was unable to ascertain on an ex-ante basis the amount of any payment or benefit it was to receive, and instead disclosed to the client the method of*

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calculating that amount (in accordance with Article 24(9) of MiFID II), it should also provide its clients with information of the exact amount of the inducement received on an ex-post basis;

iii. at least once a year, as long as (on-going) inducements are received by the investment firm in relation to the investment services provided to the relevant clients, the investment firm should inform its clients on an individual basis about the actual amount of payments or non-monetary benefits received.

8. In implementing these requirements, the investment firm should take into account the rules with regard to disclosure on costs and charges, as outlined in the 'Information to clients on costs and charges' chapter of this CP.

9. When a number of entities are involved in the distribution channel, each investment firm that is providing an investment or ancillary service must comply with its obligations to make disclosures to its clients.

ESMA's draft technical advice clearly requires firms to fully disclose any monetary or non-monetary third-party payments (or at least the method of calculating). Moreover, it requires firms to fully disclose any form of contingent payment as well on annual basis. Finally, it refers to the rules on costs and disclosure that must consequently as well be applied to insurance-based investment products (ESMA Consultation Paper, chapter 2.14).

Q10.

Yes. It is of primary importance to clarify that measures for remuneration/inducement-based conflicts of interest are quite different from other measures addressing other types of conflicts of interest (recapture that that remuneration/inducement-based conflicts of interest or the most important type with respect to potential harm for retail clients).

While prevention and management via organizational requirements might work for certain types,

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remuneration/inducement-based conflicts of interest can only be avoided to materialize to the harm of the customer when the distributional channel itself is challenged. Therefore, clients need to be enabled to effectively compare the costs and utility of different distributional channels. Against this background, disclosure is indeed a measure to deal with a particular type of conflicts of interest.

To make, again, a more general comment. The commission mandate, when stating that disclosure is not a measure in itself, seems to implicitly assume that change to insurance intermediation should not affect existing distributional channels. In our view, this is misleading. Change to insurance markets, product quality and suitability must start from distributional channels.

Q11.

Disclosure must be given product-specific, timely and disaggregated with respect to different firm or group levels. In the end, the client needs an invoice-like statement that contains easy to understand information on the exact amount of the pure service costs (costs of financial advice). Accordingly, contingent costs must be disclosed in the same manner via an annual invoice-like statement.

Concerning natural limits to cognition and boundaries to rationality, it is of primary importance that any form of information on costs, charges and inducements is designed in a way that takes the ability of consumers to understand quantitative measures explicitly into account. In the end, this ability can only be assessed in practice and must take consumer behaviour as a given, not as a variable. Financial education (i.e. change in consumer behavior) is, certainly, an important field to improve competition in retail financial markets and overall product suitability. However, considering it a primary aim is, in our view, highly misleading.

In light of the above mentioned ESMA Mifid2 draft technical advice and the incorporated provisions on disclosure of inducements, EIOPA should, in our view, concentrate on the technical specification of disclosure provisions and the development of consumer-oriented informational

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	statements as outlined in the previous paragraph.	
Q12.		
Q13.		
Q14.		
Q15.		
Q16.	<p>Yes. Beyond increased product suitability, consumers will profit from reduced costs as long as level 2 measures go for total and detailed disclosure of any distributional costs, including inducements. Economically, these reduced costs result from a reallocation of rents currently earned by insurance undertakings and intermediaries. In other words, total market efficiency is enhanced what indirectly benefits the European economy as a whole.</p>	
Q17.	<p>Yes. The concentration process that naturally arises from regulation (larger firms profit from economies of scale and generally find it easier to comply with new provisions than smaller firms) may be problematic for consumers as well as for overall market efficiency as it further reduces competition. At the same time, conflict of interest provisions are of such fundamental importance that they must be fulfilled by every supply-chain entity.</p> <p>The first part of the discussion paper identified remuneration/inducement-based conflicts of interest as most important type with respect to potential harm to customers. In the second part, we argued that, in our view, disclosure actually is an effective way of dealing with remuneration/inducement-based conflicts of interest. In light of the proportionality discussion, management-by-disclosure has another dimension as it does, in contrast to more costly organizational measures, not lead to the above-mentioned concentration process. Full and disaggregated disclosure of inducements is as easy to do for a sole trader as for a large company. Moreover, the sole trader should find it much easier to adjust his or her business model when tightening competition requires this.</p>	

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Q18.

Market inefficiency is hard to estimate as the equilibrium price is a theoretical abstraction that only facilitates thinking. A rough indicator for misallocated resources are economic rents in the insurance industry (i.e. salaries, dividends etc. exceeding those of more competitive sectors of the economy). Another measure would be the difference between the product-specific distribution costs (inducements) and the costs of product-independent advice.

Qualitative evidence on product suitability has been produced by the Federation of German Consumer Organisations (vzbv) together with the Consumer Centres of the German Federal States (Verbraucherzentralen) for other financial market sectors (i.e. retail securities markets). However, comparable methodological approaches might be as well employed to grasp the potential benefits for consumers from reduced conflicts of interest (see <http://www.vzbv.de/11326.htm>).