Financial Services User Group's (FSUG)

28.11.2014

FSUG reply to
the EIOPA Consultation Paper on
conflicts of interest in the sale of insurance-based investment products

About FSUG

The Financial Services User Group (FSUG) is an expert group set up by the European Commission following the core objective "to secure high quality expert input to the Commission's financial services initiatives from representatives of financial services users and from individual financial services experts". The mandate of the group is to:

- advise the Commission in the context of the preparation of legislative acts or other policy initiatives affecting users of financial services, including consumers, retail investors and micro-enterprises;
- provide insight, opinion and advice concerning the practical implementation of such policies;
- proactively seek to identify key financial services issues which affect users of financial services;
- where appropriate, and in agreement with the Commission, liaise with and provide information to financial services user representatives and representative bodies at the European Union and national level, as well as to other consultative groups administered by the Commission, such as the European Consumer Consultative Group, the Payment Systems Market Expert Group, the European Securities Markets Expert Group and the Expert Group on Financial Education.

Comments Template on **Consultation Paper on Conflicts of Interest** **in direct and intermediated sales of insurance-based investment products**		**Deadline** **1st December 2014** **18:00 CET**
Name of Company:	Financial Services User Group (FSUG)	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Confidential/**Public**
	Please follow the following instructions for filling in the template: ⇨ Do **not** change the numbering in the column “reference”; if you change numbering, your comment cannot be processed by our IT tool ⇨ Leave the last column empty. ⇨ Please fill in your comment in the relevant row. If you have no comment on a paragraph or a cell, keep the row empty. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. **Please send the completed template, in Word Format, to CP-102-IMD@eiopa.europa.eu . Our IT tool does not allow processing of any other formats.** The numbering of the questions refers to the Consultation Paper on Conflicts of Interest in direct and intermediated sales of insurance-based investment products.	
Reference	**Comment**	
General Comment	**The Financial Services User Group (FSUG)** is the expert group set up by the European Commission following the core objective “to secure high quality expert input to the Commission’s financial services initiatives from representatives of financial services users and from individual financial services experts”. The FSUG welcomes this opportunity to respond to EIOPA’s consultation on conflicts of interest in direct and intermediated sales of insurance-based investment products. The members of the FSUG have followed the discussions around the drafting of the revised Markets in Financial Instruments Directive and its application to insurance-based	

	investment products with close interest. This is a piece of legislation that deals with some issues at the heart of consumer protection in financial services, especially the issue of conflicts of interest and inducements. We agree with EIOPA's aim to achieve wide-ranging alignment between the regulatory regimes for investment products and insurance-based investment products and welcome several of the proposals in the paper in this regard. However, we have also identified potential gaps in this alignment and general shortcomings in the provisions of MiFID II, particularly with regard to the treatment of inducements. In our view, the provision of monetary and non-monetary inducements is the most relevant source of conflicts of interest with regard to harm caused to retail clients. Everything should therefore be done to avoid the creation of situations in which such conflicts could arise. We believe that the new regulatory regime is still at risk of allowing such situations and have in our response highlighted additional measures which should be taken to prevent this from happening.	
Question 1	We do not have access to this type of data, as we do not represent the industry. However, we are concerned that this method of evidence collection has the potential to give rise to biased policy decisions. The financial services industry has the resources to quantify costs. Consumer groups do not have the resources to estimate benefits (which are often harder to quantify anyway). Therefore there is a very serious risk that the outcome will favour the industry due to the lack of data on potential benefits of policy measures. In our view, regulators should not ask open questions about costs and benefits. They should carry out their own data collection and produce an estimate of costs and benefits and consult on the calculation method.	
Question 2	The members of the FSUG agree that the general principles, set out in Article 21 of the MiFID Implementing Directive, should also apply to insurance distribution activities. The misselling of life insurance products due to the existence of conflicts of	

interest has the potential to cause significant detriment to consumers. We also support EIOPA’s proposal that the minimum criterion listed in Article 21(e) of the MiFID implementing Directive should not exempt standard commissions and fees but should apply to all commissions and fees paid by a third party.

In our view, the provision of monetary and non-monetary inducements is the most relevant source of conflicts of interest with regard to harm caused to retail clients. In our view, article 21 of the MiFID Implementing Directive should have been reflected this by emphasizing that conflicts of interests resulting from inducements are qualitatively different from others.

Our experience is that conflicts of interest arising from inducements are on average higher in the distribution of insurance based investment products than in non-insurance based investment products because those inducements are usually higher in the former. For example, in the distribution of unit-linked insurance products, commission are paid by providers to distributors both on the insurance contract’s expense ratio, and on the underlying “units (most often investment funds) own expense ratios. Therefore, EIOPA rules on conflicts of interest for these products should be at least as strict as those issued by ESMA or EBA for other retail investment products such as investment funds (UCITS and AIFs).

We would also like to stress the need for binding legislation rather than just guidance in this area. It has been shown time and again that some situations, which always present an unacceptable risk of conflict of interest and which therefore should be banned.

The current proposals do not take adequate account of such risks by providing firms with too much leeway to prioritise monetary gain above the interest of their clients.

The use of non-binding guidance to address this is unlikely to provide the deterrent effect required.

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Question 3	We strongly agree with EIOPA's view that conflicts of interest also arise with regard to the development and management of products. We therefore support the proposal to apply the requirements of Article 21 to these pre- and post sales processes.	
Question 4	No	
Question 5	We agree with this proposal.	
Question 6	Yes, we share EIOPA's view on this issue. We therefore welcome the requirement for insurance firms and intermediaries to establish internal organisational processes to avoid and handle conflicts of interest.	
Question 7	We agree with the amendments proposed in the ESMA consultation paper as the basis for similar requirements for insurance undertakings and intermediaries. Moreover, we would like to emphasise the importance of the provision that disclosure is only ever a step of last resort. However, as stated in our response to the ESMA consultation, firms need to review the types of Conflicts of Interest (CoI) present and not solely materialised before the adequacy of their CoI policies can be assessed. Moreover, we also have concerns regarding the effectiveness of the self-regulatory approach proposed by EIOPA. In our view, the proposed review of firms' conflicts of interest policies, should consist of both an internal process of the insurance undertaking or intermediary, as well as an external review by an appropriate independent external body, e.g. the National Competent Authorities.	
Question 8	Yes, we agree with this proposal. The size of a business is in itself not a sufficient	

	measure to assess whether conflicts of interest arise and the appropriate steps to deal with them. Conflicts of interest may arise in businesses of all sizes.	
Question 9	**We have combined our answers for questions 9 and 10 as they both relate to the issue of inducements.** The FSUG is a supporter of a complete ban on inducements in the field of investment products, as inducements constitute a significant obstacle to the fulfilment of an investment firm's duty to act in the best interest of the client. This has been shown in past misselling scandals where inducements have often played a pivotal role in incentivising an intermediary to pursue the sale of inappropriate products to customers. However a complete ban should include the other types of inducements received by the distributing arm of "bancassurance" groups which typically distribute only in house group products. In that case, inducements are more difficult to identify as they occur between the asset management and insurance affiliates of the group on the one hand and the retail bank on the other hand. Such inducements are not identifiable at the individual distributor level. Not catching these inducements in an overall ban would result in only banning inducements for the small share of multi-provider financial advisors in Continental Europe. We believe that this is also further highlighted by the difficulty encountered by the supervisory authorities when deciding on a set of criteria for inducements that are quality enhancing. The 'quality enhancement' test in article 26 of the Implementing Directive is at best difficult to apply in practice, and at worst leaves significant room for interpretation by firms. This in turn will require very proactive monitoring and enforcement by the NCAs which may require resources beyond the ones currently at the disposal of some NCAS. We therefore see a real risk for continuing misselling under the guise of compliance with article 26. In our view, firms should not be given the option to manage or disclose such inducements which impair their duty to act in accordance with the best interests of the customers. Instead, firms should be prohibited from accepting such inducements outright.	

However, we are aware that MiFID II does not contain a complete ban of inducements and it is therefore of utmost importance that the proposed standards focus on the prevention of forms of inducements that have the potential to create conflicts of interest in the advice and sales process. Such prevention may require firms to adjust their business models.

As a first step we suggest a closer alignment of the EIOPA proposal with the response of the FSUG to the ESMA consultation paper on MiFID/MiFIR in this regard (question 81) http://ec.europa.eu/internal_market/finservices-retail/docs/fsug/opinions/20140522-esma-mifid2-mifir-reply_en.pdf

The treatment of investment products and insurance based investment products should be aligned as much possible to avoid the creation of an uneven playing field and the resulting potential for regulatory arbitrage.

We would also like to stress that the creation of loopholes with regard to the acceptance of inducements must be avoided at all cost. The ESMA consultation paper set out a list of criteria (page 124, para. 10) that should be used in determining that the quality enhancement test had not been met. Although we are of the view that the list could have been improved upon, especially with regard to language, it does provide a framework for regulators to work with. However, paragraph 11 on the same page immediately undermines this approach and creates loopholes.

We also disagree with the view set out by EIOPA in this consultation paper that “inducements might be used for enhancement purposes are not limited to the core services of sale of insurance-based investment products and advice in this regard, but comprise all insurance distribution activities such as introducing, proposing or carrying out other work preparatory to the sale or of assisting in the administration and performance of such products.”

We are concerned that this type of interpretation will lead to loopholes and behavior

	that distorts the market and leads to sales of less suitable or unsuitable products to consumers. For example, models, which describe the key features and simulate the life-cycle of the product, and which are provided by insurance companies to intermediaries as a "technical assistance tool" are aimed at driving sales of the product by increasing the perceived sophistication of the product to consumers. However, the provision of such simulation models might be regarded as an inducement which benefits the intermediaries as they are not forced to study the product and test it by themselves in order to be sure, that they are selling the "right" product to consumers. Exploiting the consumer biases arising from the principal-agent problem might create a typical conflict of interest even foreseen by MIFID (article 21 b) and e)). Provision of such models to intermediaries is aimed at increasing the sales of the product by presenting visually attractive features to the client at the point of sale. But the client is in many cases not aware of the methodology and technique on which such models were based and whether it fits the reality or not. At the same time, most of the clients are not eligible for obtaining the reports from such models as these models are deemed to be "internal" tools of an intermediary. In our view, this is an example where an inducement could superficially be classified as enhancing the service to the consumer but could in actual fact cause bias in both the seller and consumer and result in inappropriate sales. Additionally, we are of the view that it would have been beneficial if the issue of variable remuneration had been addressed in more detail in this consultation paper as it is directly related to the reduction of conflicts of interest at the point of sale.	
Question 10	Please see our answer to question 9	
Question 11	**We have combined our answers to question 11 and 12.**	

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	Inducements by their nature do not tend to benefit the consumer. The basic role of inducements is to further the business relationship between two financial services firms with the aim to increase revenue. Therefore, inducements are not created with the interest of the consumer mind. There is therefore a need, in our view, to ensure that the principles on conflicts of interest resulting from inducements should be strengthened to include an explicit ban on certain types of third-party payments that could lead an intermediary to sell products that are unsuitable for their customers. In our view EIOPA listed a number of examples of such sources of conflicts of interests in its discussion paper. The following are in our view of particular relevance: • Contingent commissions, profit shares, or volume over-riders; • Soft commissions (corporate hospitality and gifts, soft loans, training support, administrative support); • Remuneration linked to volume of sales; • Minimum levels of sales being required from an intermediary in order to be accepted as an intermediary by the insurer. We regard all of these as types of inducements that are never acceptable and they should therefore be banned. Firms should not be given the option to decide whether they constitute a conflict of interest on a case-by-case basis.	
Question 12	Please see our answer to question 11	
Question 13	It depends on the structure of the company. In certain cases, insurance undertakings own 100 % asset management affiliates. In those cases the relationships between the asset management affiliate and its research activities on the one hand and the insurance arm itself should be subject to review to determine whether they are “arm’s length” or not.	