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**Study on remuneration structures
of financial services intermediaries
and conflicts of interest
(MARKT/2012/026/H)
Final Report**

by

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Executive Summary

The study has been conducted at a time where according to national discussions, despite the lessons from the financial crisis and a dented consumer confidence in the financial sector, unfair practices of the financial industry as well as the sale of inadequate products like payment protection insurance (PPI) have persisted. It especially considers the effects of certain remuneration systems on the willingness and ability of intermediaries to provide the best advice and to sell the most suitable products to consumers in the retail insurance markets. It covers ten EU Member States and examines the legal, economic and sociological information available through official statistics and publicly available materials, together with the results of the consultation of national experts and a variety of stakeholder groups in the member states covered by this study. The research was done in association with the Financial Services User Group of DG Internal Market and it aims to support the work of this Group in making recommendations to the Commission.

The study spans a number of areas, including existing remuneration models, the variety of financial and non-financial incentives available to intermediaries, problematic areas such as the mis-selling of insurance products and the professions involved in intermediation. The study also catalogues some of the existing legislation and efforts made to address problems caused by remuneration structures through regulatory and educational measures. It provides some comparison with similar problems in investment services and in the brokerage of credit to consumers. Special attention is paid to the alternatives of commission and fee-based remuneration systems. The study also investigates the potential effect of any ban on contingent commissions in certain areas of intermediation.

The research was based on a study of the vast theoretical economic and legal discussion, which itself is often underpinned by empirical data and information from different countries. An important element of the study was the clarification of the various concepts in order to develop a coherent basis for the questionnaire sent to stakeholders, the results of which formed the main source of information. This study and its results seek to offer an insight into current issues facing the insurance industry with regard to the way remuneration structures may influence wrongdoing. The views expressed by stakeholders or gathered through other research have therefore been reported as objectively as possible. Both isolated positions and mainstream views have been reported. Interestingly, despite the potential variables (as a result of the number of member states or categories of stakeholders consulted), the picture emerging is much more homogenous than was first anticipated. By and large, respondents agreed that the current remuneration structure in operation in the industry creates problems and that something needs to be done in order to address this. Differences between respondents tended to emerge when it came to assessing the exact scale of the problem, as well as the action needed and potential solutions. Those are in effect points that the report does not deal with, because solutions are beyond the scope of this study. However, the report makes a number of recommendations based on the data gathered and the observations our project team was able to make.

Conflicts of interest in insurance intermediation (Chapter 1 and 3)

There is a general consensus among the European Supervisory Authority for Insurance, EIOPA, the FSUG and national governments and financial supervisors that certain remuneration models in insurance intermediation are prone to creating a conflict of interest which can lead to forms of mis-selling and consumer detriment. These include

churning, twisting, overcharging, inflated products, forced bundling, the sale of unsuitable products or the confusion of products, and lack of transparency. Nearly all respondents expressed their view, that the logic of commissions leads to mis-selling. This potential for conflicts of interest is attributed to insurance intermediation, which combines objective and subjective access to insurance products. The intermediary opens the door to a particular product which is available through him (broker function) while his advice may allow consumers to identify their own needs and relate them to the range of affordable offers available.

It is in both areas that, according to our survey, there is growing concern about insurance intermediation in all 12 Member States. This is firstly due to the variety of products offered. This is artificially reduced when intermediaries are dependent on the supplier. Secondly, it stems from the fact that inappropriate advice may identify consumer needs which do not exist at all or at least not to the extent proposed. Thirdly, concerns arise because other products are available on the market but are not offered through this intermediated advice, although they may be more suitable or cheaper. After-sales services offered by some insurers may be more responsive to difficult situations than the ones offered by intermediaries. The short-term perspective generated by first-year commissions, and the conflicts faced by an intermediary who has to *serve two masters* and integrate brokerage and advice services were both seen by a majority of respondents as having an important role in generating conflicts of interest. Problems appeared to be concentrated in life insurance, especially when bundled with investment (capital life) or with credit (payment protection insurance, endowment credit). Bancassurance was named as a major source of mis-selling.

Remuneration (Chapter 2)

There is a large range of supplier-led incentives for promoting the sale of financial services. Direct incentives include commissions linked to specific products and/or the amount of sales (either by unit or, most frequently, by value). Indirect incentives comprise score systems, rankings and job promotion in multi-level marketing systems. These incentives are typically linked to the gains the supplier expects from the sale of its goods or services. By contrast, the fees paid directly by the customer usually represent the time invested by the independent advisor in consulting the customer about his or her circumstances and providing advice accordingly.

Volume-based sales commissions remain the most widespread form of remuneration for advice in insurance, credit and investment markets, except in countries that introduced a ban on commissions (such as Finland, Denmark, the UK and the Netherlands). Within the commission-based remuneration system, many different schemes are used. Those schemes are not published by providers. Similarly, in most countries, intermediaries do not disclose the form and level of remuneration they receive. This is a key problem for consumers as also suggested by the findings of a parallel internet based exercise that requested offers from various intermediaries. For insurance markets, we find that volume-based sales commissions prevail in product distribution by tied and linked agents, brokers, bancassurance and retailers. The model for and amount of commission payments vary according to insurance intermediary and product type. Brokers tend to receive higher commissions compared with tied and linked agents. Sales commissions in life insurance are based either on the insurance sum or on the annual premium, or in non-life insurance simply on the annual premium. In addition, intermediaries usually receive portfolio commissions based on the annual premium of both life and non-life insurance. Commission rates are usually higher in life than in non-life insurance. Our own calculations for Germany show that 93-94% of total life insurance commissions are sales

commissions, while this percentage declines to 72-80% in the health insurance market. On the basis of OECD statistics, of the total commissions paid by insurance companies, we find that commissions in the life insurance market reach on average 4.3% of total gross premiums per year in the selected Member States. This ratio is highest in Ireland (14.7%), which can be explained by brokers' large market share and the tight oligopoly of three large insurance companies that compete intensively for market share by paying higher commissions.

The major advantage of fee-based advice is its greater transparency. However, hourly fees may often be more expensive than the commissions included in the insurance premium (e.g. 400-500 euro for 1.5-2 hours financial advice without additional fees for advice services by email, or by mail in Germany). The experience of countries that introduced a ban on commissions shows that consumers are unwilling to pay the high fees of intermediaries (Finland). It also shows that customers have to pay more for financial advice than they did before the ban (UK). Finally, following the ban, the number of brokers or advisers declined (Finland, Denmark, UK), and this increases their market strength in setting higher fees. In Denmark, brokers have found ways to bypass the ban on commissions in the life insurance market with the effect that consumers have no influence on the pricing of their life-insurance contracts. In the UK, the ban on commissions for financial advisors did not lead to big changes in the interaction between customer and adviser. Most advisers avoid issuing separate invoices for the advice and the product and still opt to recover their fees through the premium payments collected by the provider. British banks are also giving up independent advice business completely in order to concentrate solely on the support of wealthier customers through external independent intermediaries. In investment markets, volume-based fees are used frequently and provide incentives to focus on customers with a comparatively high levels of wealth to the detriment of less wealthy and more vulnerable consumers.

Intermediaries (Chapter 4)

Intermediaries can be classified as follows:

- Employee: Provider's own staff, legally linked to the supplier through an employment contract.
- Tied or exclusive agent: can only promote the service of one particular provider either individually or as part of an organisation.
- Broker: not tied or linked and works on behalf of several suppliers and/or concludes contracts for a client on a commercial basis without having been contracted to do so by a provider or a provider's agent, or a sales company as a legal entity separate from the provider.
- Bancassurance: Bank sales force selling products supplied by an insurer. Partnership or relationship between a bank, acting as agent or broker, and a third party financial services provider. The bank's sales channel is used to sell the products of an insurance company.
- Retailer: Sale of an ancillary product or service, often by retail firms like car dealers, acting mostly as a tied agent.
- Fee-based Adviser: Anyone advising third parties in respect of agreeing, amending or examining financial services contracts or representing the client out of court vis-à-vis the financial services provider without receiving any economic benefit from the provider.

Special regard has been given to multi-level marketing systems whose structure often escapes these classifications. The agent may not be tied in the sense of the definition

given in the Directives concerning the intermediation of financial services. But they may in fact be even more dependent. They are either employed by the agency or act for it as a broker. Similar to bancassurance, the dependencies of the intermediary are themselves mediated by an organisation (MLM or bank) which passes its own dependency on to its sales personnel. We have therefore borrowed the traditional term used in consumer credit law for such dependencies and defined a new category of linked agent/intermediary which includes MLMs connected to multiple insurers, often in a (structured) sales organisation under fixed contractual relationships with one or more providers, or is owned by those providers, and is organised through multiple hierarchical levels. The link is based on the “commercial unit” as defined in the Consumer Credit Directive 2008.

Because employed and tied intermediaries are sub-categories of linked intermediation, we need only be concerned with two broad categories: linked (i.e. dependent) and independent intermediaries. We find that brokers in Germany are mostly “independent” but totally dependent if linked to a structured sales organisation. Meanwhile most brokers in retail insurance in the UK are “linked agents”. The word “broker” is therefore misleading. In fact, most intermediaries are linked in one way or another, highlighting a structural issue at the heart of the remuneration problem. As a result, product providers can employ many methods to steer intermediaries in the direction they want their marketing effort to take.

International statistics differentiate between only four distribution channels of insurance products: (1) direct writing (employees and distance selling), (2) agents (tied and multi-tied intermediaries who represent the interests of the insurer), (3) brokers (intermediaries who represent the interests of the insured), (4) bancassurance (provision of insurance products by banks or lending institutions, which may act as an insurance agent, bank employee or insurance broker). They show that life insurance in particular and, to a lesser degree, non-life insurance, are sold through intermediaries, because searching products (market matching) and alleviating asymmetric information problems for consumers is an important task that intermediaries undertake in this market. Distance-selling of life-insurance plays only a minor role in all countries, because customers need advice for many products that distance-selling channels are unable to provide. Brokers dominate in the United Kingdom and Ireland. Meanwhile, bancassurance has the largest market share in Italy, Spain, France and Austria, while agents prevail in Slovenia, the Netherlands and Germany. Non-life insurance products are mainly distributed through agents and brokers, with agents generally playing a bigger role than brokers. Bancassurance plays only a minor role in non-life insurance, while direct selling is used more often than in life insurance markets.

These statistics do not take into account the dependencies through framework contracts, the inclusion of agents into internal information and educational systems, and by different legal contract forms, which are also reflected in all kinds of factual payments such as commissions and salaries, lump sum payments and bonuses in various combinations.

Regulation (Chapter 4)

Remuneration regulation takes various forms. There is no one model that prevails across the Member States studied. The four pillars of regulation are: dependency, transparency, prohibition of certain remuneration forms and professional qualifications.

The definitions in the law vary across the EU. Some Member States define and regulate activities, while others focus on individuals. There is no harmonised understanding of

what conflicts of interest are, or what behaviours should be expected from which intermediaries. This explains, in part, the divergence in requirements with regard to authorisation and licensing, with some intermediaries subject to professional qualifications while others are not.

The main types of restriction include employee remuneration, caps on remuneration, forfeiture of remuneration and duration of contracts. A number of bans are in place, mostly targeting brokers. The exclusion of many consumers, pushed into an advice gap, is of concern. Bans tended to be justified on the grounds that the ban was the most efficient means of avoiding conflicts of interest. However, the research shows that bans seemed to be confined to certain products or to certain types of intermediary. This has the propensity to cause detriment to the most vulnerable consumers and to confuse the field for all consumers, because the rules on protection may change from one product to another or from one intermediary to the next. This may make comparisons difficult.

This amounts to a patchwork of regulation across all Member States. No general statement as to the effectiveness of the architecture of the legislation in place in a given country is therefore possible. This results from the many factors that contribute to the efficacy or the demise of legislation at national level, notwithstanding the patterns of regulation also highlighted above.

The two alternative philosophies of insurance also characterise the different degrees of regulation of intermediation. The first is that insurance is seen as a community good. In this case, the marketing of insurance aims primarily to provide as much insurance cover as possible for as many of the risks in society as possible through solidarity systems, thereby increasing entrepreneurial attitudes and advanced risk-taking, as well as preventing unwarranted impoverishment through unforeseeable events. Intermediaries are seen as educators and advisors, especially for the more disadvantaged. Door-step contact is seen as necessary and the sale of insurance through the Internet as problematic.

The second philosophy sees insurance as a commodity like any other financial service, for which each consumer exercises individual demand, and the availability of wide coverage for the individual at low prices are the predominant objectives of regulation. The differences in the opposing systems are most visible in the examples of the UK and Denmark on the one hand and Germany and France on the other. This may explain why the former ban commissions while the latter still ban the consumer rebate of commissions.

These approaches also vary in all countries according to category of insurance. Non-life insurance, such as health, motor vehicle and disability insurance are more often seen as public goods, while life insurance competes with other savings systems for which the competitive aspect is crucial. The alternatives are most significant where the goal of effective advice for all customers may compete with that of lower prices for the consumers who exercise a rational choice. Political decisions based on these different views are also central to the question of remuneration systems. More individualised remuneration systems may reduce the amount of advice available to all by improving its quality for some, while generalised remuneration systems may cross-subsidise advice for those who would not be able to afford it if it were provided as a separate product.

Recommendations

- I. The marketing of insurance products through intermediation should be regulated, and the purpose of regulation should be to achieve improved standards of advice and

minimise bias in the recommendation of certain products. It should aim to achieve this through competition, transparency and by placing restrictions on certain marketing channels.

1. The intermediation of products whose sale is promoted and incentivised in such a way that the amount of insurance, its coverage, service quality and price are not sufficiently responsive to consumer demand should be regulated.
 2. Transparency, safeguards and adequate supervision have to be put in place. Transparency must be deployed in a way that enables consumers to understand the key elements presented to them. For this to happen, three elements are crucial: timing, form and content.
 3. The advice necessary to make the right decisions for consumers needs to be dispensed at an opportune moment. It has to be part of the sale process and part of the offer.
 4. Volume-based commission payments, especially where paid in advance or not extended over the duration of the service, may constitute a significant indicator of dependency on the part of intermediaries. The insurance contracts to which they provide access should be seen as falling within a broader category of "linked insurance agreement".
 5. Consumer concerns about issues such as bundling, lack of exit and choice, unmet coverage needs or complexity cannot be solved by the markets alone. Certain products, including bundled insurance in payment protection insurance and endowment credit, should be given special attention.
- II. Fee-based systems should have the flexibility to develop standardised packages for small amounts and in mass insurance, so that their cost structure remains competitive and affordable.
1. The offer of independent brokerage services should be kept free of all incentives which could affect the advice given. Independence should be clear, unambiguous, transparent and reflected in the form of remuneration (Danish example).
 2. Fee-based advice should be able to compete with commission-based advice.
 - a) This could be achieved by increasing the requirements and legal responsibilities placed on commission-based advice and Internet sales without advice.
 - b) The accumulation of remuneration from suppliers and consumers should be prohibited.
 - c) A network of independent, not-for-profit financial advice providers should be developed with public funding to deal with insurance where the total premiums are relatively small but the cover is of great importance to consumers, especially those with limited means.
 - d) Consumer rebates should be enforced in all EU countries as a first step.

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Preface

The present research concerns remuneration schemes for intermediaries. Since this research has been mandated by DG Internal Market in cooperation with the Financial Services User Group (FSUG) the reader will be mindful that it is situated within a broader political discussion, mirrored in the responses that the research team collected from stakeholders and experts in the twelve selected countries.

The broad question on the economic, legal and social impact of remuneration systems in the EU and the limited means and time frame requires some clarifications as to the outcome. The research is based on empirical evidence derived from own empirical research in all 12 countries, analysed on the background knowledge of the authors from past research projects and an analysis of the empirically informed economic and legal literature in this area. This research does not claim to provide a representative picture on the quantitative distribution of remuneration schemes, opinions and consumer problems in this area. In the frame of this exploratory research, conducted primarily in the first half of 2013, we tried to investigate the forms of remuneration schemes, opinions of primarily insurance intermediaries voiced from different stakeholders as well as regulations present in the EU to cope with the existing problems.¹ We did not pretend to answer the question how much and how important the described phenomena are. This is why the initially 10 Member States to which Austria and the Netherlands have been added have been taken because it can be assumed that we can find in these states who represent a third of all MS and the vast majority of its population basically all those elements of remuneration schemes in insurance mediation which characterise an already highly globalised market. We are confident that the experts chosen for this project in each country as well as those providers, intermediaries and consumer organisations who answered a very thoroughly prepared and sophisticated questionnaire were able to assess whether the supposed elements were present in their countries and provide sufficient evidence for the research team to verify. With a less demanding questionnaire we could have got more responses but probably more opinions than the objective information we needed. Also the cooperation of the supplier side could have been better even in this very short time frame available for the feedback but we learned that in the wake of a fierce political discussion on a ban on commissions during the preparation of two important Directives on financial intermediation (IMD II and MiFID II) in which the FSUG had already taken position some suppliers were uncertain if such information would be part of the political discussion which could lead to a ban. Anyhow the feedback also from the supplier side was of high quality and we are confident that this research provides a first overlook on a problem which is discussed worldwide, concerns nearly all consumers and a large part of the financial markets in the EU and still needs theoretical clarifications about its nature, allocation and the form of solutions appropriate to alleviate the negative outcome for financial advice to consumers.

The tasks for this research are defined in the proposal and the ToR. The Annual Report 2012 of the FSUG contains further deliberations. As far as the main definitions of the assumed conflict of interest are concerned we follow the proposals of the EU Commission and the Parliament concerning investment services (MiFID II) and insurance services

1 In some cases the answers showed that they also concerned intermediaries active in investment services. Since both groups are largely overlapping the answers should be read with regard to financial intermediaries in general. If not, insurance related issues were expressively addressed.

(IMD II)². For the assessment of the problem as well as its solutions we follow our own research.

2 Proposal for a Directive on insurance mediation (recast) COM(2012) 360/2 2012/0175 (COD). The readers should keep in mind that all the references to IMD II and MiFID II are to legislations in the proposal/negotiation stage (at the time of drafting of this report). The definitions are highly likely to change by the time discussions take place around the study. From a legal point of view, the only binding definitions to date are those in IMD I and MiFID I respectively.

1 Conflict of interest: How is the problem defined?

1.1 Perceptions at EU level

Financial incentives are the driving force behind the sale of goods and services. With respect to B2C commerce the general assumption is that businesses supply goods and services in order to realise revenues generated by consumers, who want and choose the offering of the business concerned. Producers and those creating the distribution channels necessary for realisation of the available marketing opportunities thus invest labour and capital to 'please' the consumer.

The role of intermediaries in this chain has always been problematic. Intermediaries do not produce, transport or store the goods and services wanted by consumers. Their main role is to provide information and sometimes access to products and services offered by others. For consumers, it is always difficult to understand the role of intermediaries because it appears to be artificially inserted between supplier and consumer. From a consumer perspective, intermediaries could easily be dispensed with, with the result that there would be direct access to products without additional fees, and without mis-selling.

A judgment delivered by the German Supreme Court as long ago as 1988 held that the cost of credit brokers had to be inserted into the price of the credit services because the use of an intermediary would "primarily serve the interest of the supplier" and not the consumer.³ Similar concerns have been raised with regard to estate agents. In the context of housing and credit, consumers usually know how much they have to pay for the services of the intermediary because they pay either in cash or through additional credit. In insurance and investment, the remuneration of intermediaries is invisible or at least intangible, because it is generally paid by the supplier to the intermediary. Its effect on the consumer's budget becomes apparent only when the contract is terminated early and a significant part of the amount saved for example into a capital life insurance contract is lost. In capital life insurance (endowment policies), for example, the broker's commission is paid in full immediately after conclusion of the contract and debited to the virtual account of the customer's savings. In payment protection insurance, hidden provisions which had to be prepaid and are therefore financed together the loan ensure that a consumer remains significantly more indebted when the loan is accelerated.

This had led to the hypothesis that the form of remuneration of intermediaries creates incentives for bad advice and the sale of inappropriate products. "Conflicts of interest" have been identified resembling those under scrutiny or already regulated by the EU in the context of the remuneration of financial services providers.⁴

Currently, the most visible effect of this discussion is in the Netherlands in the form of the complete ban on volume-based commissions for independent advisors in the sale of

3 „weil die Einschaltung eines Kreditvermittlers im allgemeinen im weitaus überwiegenden Interesse der Bank liege, die hierdurch eigenen organisatorischen und finanziellen Aufwand erspart“ (Bundesgerichtshof, Decision as of 13.10.1988 – III ZR 139/87 (WM 1989, 167) with reference to previous decisions in NJW 1981, 1206; NJW 1987, 181)

4 See as an example Art. 93 (a) and (c) Directive 2013/36/EU of 26 June 2013 (CRD IV): "variable remuneration is strictly limited as a percentage of net revenue where it is inconsistent with the maintenance of a sound capital base and timely exit from government support". Further Art. 14b (1) (j) Draft UCITS IV; Paragraph 13, ESMA Guidelines; Paragraph 94, ESMA AIFMD Guidelines.

complex financial products, which came into force in 2013. The reasoning for this ban is set out in the following statement by the Dutch financial authority:⁵

a. For decades, the financial advice industry was earning commission from insurance firms and banks in return for advising their insurances and mortgages to consumers. This system led to mis-selling scandals involving unit-linked insurances and payment protection insurance policies.

b. Before the ban on commission inducement rules were applicable to financial services providers. The inducement rules were intended to remove excessive incentives that may be generated by commissions. Our ministry of Finance wanted a change in culture with financial service providers, a change from product pushing to advice in the (best) interest of the customer. An evaluation of the inducement rules clarified that the inducement rules were helpful but not strong enough to stop the wrong incentives and did not lead to the change in culture. After all, you don't bite the hand that feeds you. The Ministry of Finance decided to introduce a complete ban on commissions for independent financial advisers.

The Financial User Group, which initiated this research, broadened the analysis to other forms of dependencies beyond remuneration schemes which could produce a similar conflict of interest in its 2012 report:⁶

FSUG takes a focus on remuneration structures in financial services intermediation. Various distribution channels of financial services products (for example insurance policies aggressively offered to consumers) will be stimulated not only on the basis of cash incentives, but also act based on non-cash incentives. Intermediaries (e.g. brokers, agents, investment advisers) and sales force may be motivated by a broad range of instruments (e.g. through positive incentives like travel offers). Apart from (high) sales commissions and aggressive sales targets in bank branches or insurance companies, sales staff positions can give rise to conflicts of interest and cause potential detriment to users. Conflicts of interest may arise from the fact that retail financial intermediary companies are owned by banks, insurance and investment companies. From the consumer's point of view fair and adequate remuneration structures are required which lead to better advice and sustainable products.

The President of the European Supervisory Authority for Insurance EIOPA, Gabriel Bernardino supported such view when he wrote:

*"We need to take a courageous look at conflicts of interest. Unfair practices leading to consumer detriment in the insurance and pensions market are often due to situations of conflict of interest. Insurance is an industry where agency incentives can be the main driver of the kind of product to be sold. Sometimes these result in the sale of products which are not suitable for the consumers concerned."*⁷

The theme of conflict of interest is therefore central to this research.

1.2 Perceptions in the Member States (survey)

Stakeholders and experts were asked how far they assumed different intermediaries were in a situation of conflict of interest due to their relationship with suppliers and how they would characterise this conflict. Conflicts of interest can potentially exist on a number of different levels. Whilst the most intuitive and potentially harmful one for the consumer is the incentive for an insurance intermediary to prioritise short-term gains ahead of interests seen from a long-term perspective (where the business interest in a quick sale transaction has to be weighed against the interest in best serving the consumer's needs and hoping for future relationship and custom), two other conflicts that may also lead to suboptimal outcomes were outlined in order to receive stakeholder views.

5 AFM, A ban on commissions in the Netherlands, paper presented at the International Conference in Financial Services in Hamburg, June 2013.

6 Accessible on the Internet at http://ec.europa.eu/internal_market/finservices-retail/docs/fsug/annual_report_2012_en.pdf. Although this study is mandated by DG Internal Market the EU Commission has provided the FSUG to define and accompany this study. This cooperation between the team and FSUG started with the kick-off-meeting on February 12, 2013 in Brussels with the presentation of the research design to the FSUG and its intense discussion.

7 From the Consumer Strategy Day, Frankfurt, 6th Dec. 2011. Taken from the trade association MEDI (Monitoring European Distribution of Insurance) paper: "Towards IMD2: The Drive for Enhanced Transparency" which outlines all the key issues which our Study will investigate.

These three dimensions are:

- short-term profit maximisation vs. long-term customer satisfaction: The extent to which incentives to promote short-term considerations (increasing the intermediary's income or profit by advising the customer to choose the product or provider with the highest commission) ahead of long-term consumer interest (providing the best advice to the customer)
- intermediary for the consumer, seller for the insurance company: The incentive of an intermediary that has a relationship with several insurance undertakings to sell the products of the insurer that provides the highest remuneration or non-monetary benefits (e.g. training of intermediaries, larger portfolio with one group, additional or undisclosed commissions or inducements etc.)
- incompatible roles as advisor and broker: conflict of interest for intermediaries whose tasks are to provide services both to suppliers and customers e.g. intermediaries handling claims⁸.

Respondents were distributed evenly across the various stakeholder groups (users, suppliers incl. intermediaries, public authorities, and legal experts). They provided a relatively homogeneous set of answers. It was only in response to the question as to which group was most exposed to such conflicts that the supply side, which included brokers, replied that brokers were the least exposed to conflicts of interest, while the group of users ranked them as similar to other groups of intermediaries such as tied agents of bancassurance.

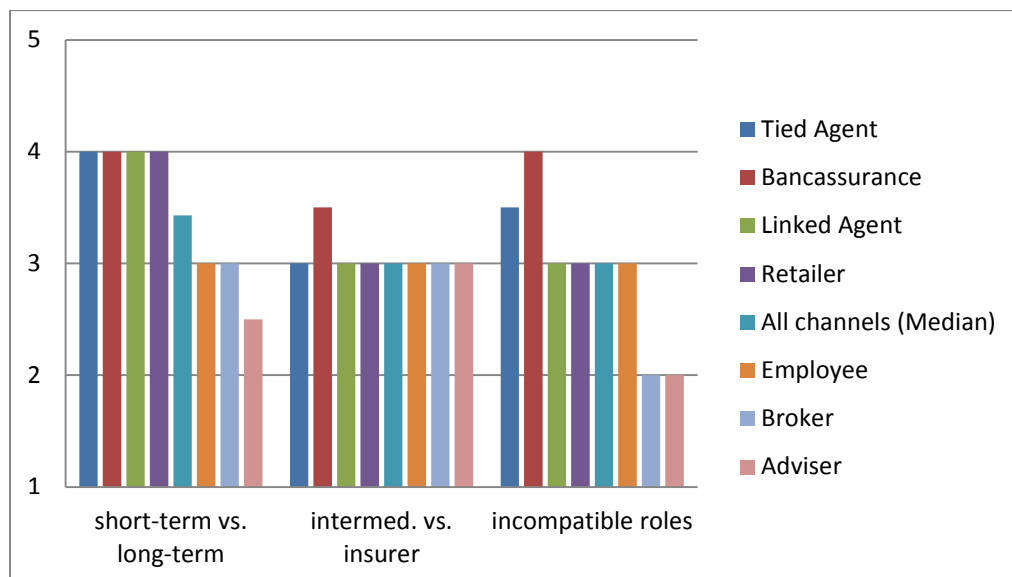
Tied and linked agents were seen as especially exposed to conflicts of interest. Brokers and advisors were seen as less exposed than other groups of intermediaries.

Question D.3 of the questionnaire sought to collect from respondents an assessment of the extent of potential conflict of interests along the three dimensions by soliciting a rating using a scale of 1 (very insignificant) to 5 (very significant). Additional comments suggested that respondents may have had difficulty understanding all three dimensions of conflicts outlined and some thought that a conflict of interest existed but did not answer the question because it was too complex.⁹

8 For example, brokers were reported as having a dual role in the procurement. Since they act as an independent adviser and also compete with the bidding life-companies for the administration and service of the contract. This gives them an economic interest in the customer's choice.

9 For example "Sorry, this question is just too complicated for me to understand. So I am not going to fill it in.". In addition, other potential conflicting situations were not covered such as the incentive to cross sell whereby a conflict of interest arises from an intermediary marketing or selling insurance products in association with the supply of other products or services (e.g. credit insurance offered by a bank associated to a loan).

Figure 1: Conflicts of interest seen by stakeholders



In the empirical survey, stakeholders and experts at national level were asked about the relationship between the systems of remuneration of intermediaries and the mis-selling of insurance and investment products.

GENERAL PERCEPTIONS

72% of respondents reported an on-going national discussion of mis-selling. Responses made reference to scandals and to political and legal activity as contributing to awareness of this problem¹⁰. The following statements, selected from all responses, show that, with one exception, all Member States are aware of the problem and have taken some form of administrative or legal action. An outstanding example of the problem is seen across Europe as the scandal of overcharging in the form of payment protection insurance.

Denmark: Yes, in retrospect following the financial crisis the banks in particular have been focusing more on selling products than on the customer's needs. The cases of bad advice before the Complaint Board of Banking Services [Pengeinstitutankenævnet] suggest that it is one of the most important issues. (Legal Expert)

Finland: Overall answer would be that there are some problems concerning mis-selling, but this not a major problem. (Authority); There are only a very few mis-selling cases dealt with by the Financial Services Ombudsman office. Not a major problem. (Other TA)

France: It is a major problem when large amounts of money are added to contracts, particularly life insurance. For example concerning real estate loan insurance: "crédit et assurance emprunteur : information, conseil et mise en garde." (Legal Expert); Of course, there may be situations of mis-selling, but these situations remain exceptional. Compulsory advice on sales and legal requirement that customers have the opportunity to compare or terminate insurance contracts, to exercise their rights of withdrawal reduce risks of mis-selling (TA Ins.); La vente abusive de produits financiers est un problème en France. Les professionnels qui vendent ces produits ne fournissent pas les informations nécessaires pour compenser le caractère illisible de leurs contrats. (CA)

Germany: Remuneration gives the wrong incentive: Most money flows only by concluding new contracts! (CA); Die Beschwerdequoten über fehlerhafte Beratung bei der BaFin und beim Versicherungsombudsmann für Versicherungen bewegen sich seit Jahren auf einem konstant niedrigen Niveau. Auch die Rechtsprechung ist nur vereinzelt mit Fällen von Falschberatung befasst. (TA Ins.)

Ireland: The mortgage arrears crisis and the levels of unsecured debt are examples of past poor practices. The investigation of payment protection insurance mis-selling is a further example. (Other CA); Mainly of investment products. Not specifically of insurance products (Other CA)

10 Often: (DE, DK, IE, IT, NL, UK), 36%; partial problem (AT, FI, FR, IE, IT, SI, PL); not or do not know (DE, FI, FR, IT, IE, PL) see Annex Table Q59.

Italy: Problematic areas can be identified: - credit contract, insurance as collateral to credit contracts, automobile insurance. As previously clarified, there are some comments in the legal literature but the case law is quite limited. (Legal Expert)

Netherlands: Yes, it WAS. With current regulation, the situation has improved a lot. As a starting point (Other CA); This is why we introduced a ban on commission. (Authority)

Poland: We identified this problem in relation to selling insurance by banks. The Polish Insurance Ombudsman prepared two reports on this issue in 2007 and 2012. (CA); Forced bundling (combined with importunate practices of the distributors and information asymmetry) - is the one kind of mis-selling of financial services that is growing. Nevertheless, to say that it is a problem in Poland would be an overstatement. (Legal Expert)

Slovenia: From our regular and periodical testing of insurance products we are observing all of the above mis-selling practices, more often in personal insurance but in other types of insurance as well. (CA)

UK: Scandals about the mis-selling of pensions, endowment mortgages and annuities erupted before the creation of the Financial Services Authority (FSA). Contributing to exposure of the scale of the mis-selling of PPI is one of the regulator's achievements. The BBC has quoted estimates of £25 billion as the full redress bill. According to the Financial Ombudsman Service only about 1 in 10 PPI customers has made a claim thus far. The FCA recently (July 1, 2013) has taken enforcement action against a mobile phone insurance intermediary, imposing a penalty of £2.8 million fine for a variety of misconduct including failing to respond adequately to customer complaints about mis-selling. On July 16 2013, the FSA published its decision notice reporting on enforcement action against Swinton Group, a major insurance intermediary, for mis-selling add-on insurance products. (Legal Expert)

In the general debate, remuneration schemes for intermediaries were the focus of criticism. But when more possibilities were enumerated, as in our questions, the answers were more differentiated.

When stakeholders were asked to assess the link between problems and either remuneration models, types of intermediaries or types of products, 17 of 23 respondents (73%) confirmed that remuneration models were prone to causing consumer problems (59% totally and 14% partially)¹¹. Variable remuneration structures were reported to encourage excessive sales and high first-year commissions were specifically identified by respondents as a potential source of problems by making an insurance intermediary more prone to "twisting" i.e. causing limited value replacement of existing policies or poor renewal practices generally). With regard to intermediaries, 59% of respondents saw the nature of the intermediary as prone to causing consumer problems (41% totally and 18% partially), and exclusive agents were assumed to pose a higher risk of mis-selling. Although non-exclusive agents can operate in a much less transparent and impartial manner than exclusive agents, they may have been identified with respect to the fact that the fewer providers an agent is able to choose from, the narrower the spectrum of products to choose from¹². Finally, a similar 59% of respondents asserted that problems were linked to the product, with certain products like payment protection insurance mentioned numerous times by the respondents as a product potentially causing consumer detriment, especially in the context of some insurance products being difficult to understand and not easy to compare...

The following list of arguments against remuneration schemes for insurance intermediaries received support from various countries. We therefore assume that, at least in the view of experts and stakeholders, such problems do exist although our data source does not allow us to draw any conclusions about the significance of the problem in the context of the general distribution of financial services.

11 Respondents that said they did not see remuneration models as an element more prone to causing consumer problems came from Denmark, Germany, France and Italy.

12 A spectrum made yet smaller still when the remuneration model provides for more benefits and thus an incentive to sell certain products from one provider rather than from another.

AGREE TO THE ARGUMENT

“Commissions lead to mis-selling”

Most respondents saw this as a logical statement. They considered it to be self-evident that *he who pays the piper calls the tune*. The responses included the statements that *high first-year commissions lead to hit-and-run practices by salesmen (NL) or agents and intermediaries are often driven by the highest remuneration a certain product offers to them (SI)*. In a representative survey we expect even more support for this thesis. There was however a significant difference between the general assumption that certain outcomes are driven by financial incentives and the perspective of those who were potential victims of those incentives, who agreed that in fact the dominant reason for the behaviour was the expectation of financial gain.

BROADEN THE ISSUE

“Intermediation as such is prone to mis-selling”

Nearly all respondents assumed that intermediation, irrespective of remuneration system, is prone to the mis-selling of retail insurance. The close relationship between intermediary and producer, the information asymmetry on the part of the consumer, the irrational level of consumer confidence in representatives who provide home visits, and the dual role in the acquisition and administration of insurance contracts were seen as important factors which could prejudice the independence of financial advice.

A different view was also expressed, however. The French respondent expressed concern that the purely logical construction of a detrimental relationship between *certain forms of distribution* and bad advice may not stand up to a comparative empirical test with regard to the problems attributed to them: *Agea is surprised that a questionnaire issued by the Commission can, in the way the questions are formulated, communicate negative a priori on specific forms of distribution, that by exclusive agents in particular. Agea wishes to highlight that the general insurance agent is subject to an obligation to advise, is involved in a durable relationship with his clients and that he is equipped with products in the market (for no other reasons than competitive pressure)*. The Polish expert was of the opinion that the problem was a problem of bancassurance and not of intermediation in general, because bank employees would be insufficiently informed about insurance.

NARROW THE ISSUE

“High first-year commissions are the problem”

The Polish expert reported that the volume-based profit orientation of commissions alone did not cause the problem. Another factor was the payment of commissions primarily in the first year.

“Only certain forms of intermediation are prone to mis-selling”

Further respondents pointed to specific factors that defined the nature of intermediary advice. These include the number of providers whose products an insurance intermediary was allowed to sell, the relationship between intermediary and provider (whether it was “tied”), and the specific circumstances of the sale (“cross-selling”, and “bundled sales”):

“Mis-selling depends on the complexity and suitability of the product”

The reason for mis-selling was attributed to the complexity of certain products, including PPI, capital life insurance (endowment policies) and bundled contracts, which have been particularly prone to mis-selling. The Polish respondent summarised the concerns also voiced in France, Denmark, Ireland, Italy and Ireland as follows: *We do consider some unit-linked insurance to be products that gain profit only for the insurance company and the intermediary. This is also a problem with PPI, where insurer and bank prepare a product that is supposed to be most financially effective for the insurer and bank, not for the consumer.*

OTHER REASONS ARE OF EQUAL IMPORTANCE

“Consumer capability”

With regard to consumer capability consumer problems were attributed to the fact that consumers themselves are not sufficiently educated to understand what they are buying. However while consumer education is of course necessary, consumers are unlikely to acquire the knowledge intermediaries have of insurance products.

“Lack of advice”

The Slovenian and French respondents pointed to the need to compel intermediaries to provide adequate advice. According to them this obligation, which exists in some countries, would only be effective if the intermediary had the capacity to provide good advice.

“Trust and duties are more important than the remuneration system”

Earning the trust of a customer and gaining their long-term business was seen as important in preventing an intermediary from seeking short-term gain.

Germany: Remuneration systems are designed in a way that a faithful relationship with the customer is encouraged, enabling a life-long support by the intermediary. Only this lies in the mercantile interest of an intermediary.

France: It never is the remuneration model that causes a problem. Every transaction implies by its very nature a pseudo conflict of interest with the client, in so far as the later always has an interest in paying little. What can cause difficulty is: models where there is no competition; models where supervisory authorities cannot ensure themselves of the quality of the advice given; models that are not enshrined in a durable commercial relationship.¹³

1.3 Scientific perceptions

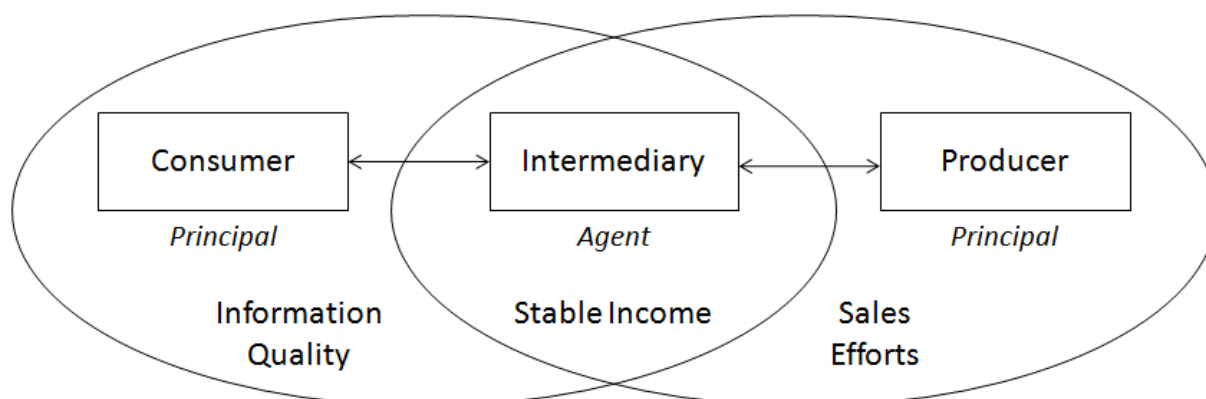
1.3.1 Economic perspective: volume-based versus risk-based remuneration

Principal-agent theory deals with conflicts of interest that arise when a principal hires an agent to perform duties on his behalf. It aims to find optimal contractual solutions to the problem of motivating the agent to act in the best interest of the principal rather than in

¹³ iff's own translation. Original answer: 'Ce n'est jamais le modèle de rémunération qui pose problème. Toute transaction implique par nature un pseudo conflit d'intérêt avec le client dans la mesure où celui-ci a toujours intérêt facilement à payer peu. Aussi ce qui peut poser des difficultés c'est :- des modèles où il n'existerait pas de concurrence,- des modèles où il n'y aurait pas de possibilité pour les autorités de supervision de s'assurer de la qualité des conseils donnés. - des modèles qui ne s'inscrivent pas par la durée de la relation commerciale avec le client. Il s'agit pour agéa du critère le plus important, car il permet de concilier l'intérêt à court terme du client -trouver une bonne couverture adaptée à ses ressources- avec l'intérêt à long terme de l'intermédiaire. Le fait d'être en relation commerciale suivie, de croiser ses clients, d'être implanté et connu localement, bref de s'inscrire dans la durée empêche toute velléité de réaliser des coups", de faire de la rotation commerciale.'

his or her own interest in the presence of uncertainty and asymmetric information between both parties. Financial intermediaries who provide advisory services to consumers and brokerage services to producers face a multi-task agency problem arising from two principal-agent relationships (see Figure 2).

Figure 2: The multi-task agency problem



On the one hand, they are delegated by consumers, as principals, to research products and provide expert advice. On the other hand, they are delegated by producers, as principals, to distribute their products. Consumers are mainly interested in high-quality information, while producers are interested in high sales. Risk-averse intermediaries are interested in a stable income and maximisation of their profits (income minus expenses). The various objectives of the principals may be in conflict with one another. Remuneration schemes are used to align the interests of principal and agent. However, the remuneration required to elicit effort in relation to one task (selling products) may create a conflict of interest for the agent on another (providing adequate advice).

Remuneration based solely on the outcome of the intermediation activity would not be optimal. A mix of a fixed salary or fee and outcome-based remuneration is necessary to achieve an appropriate balance between risk-sharing and incentives.

Incentives are misaligned and conflicts of interest arise if intermediaries are remunerated through schemes that impose incentives against the performance of their main task (negative sign in Table 1).

- When the intermediary's primary task is *matchmaking*, initial commissions are most effective.¹⁴
- When the intermediary's primary task is to *alleviate ex ante asymmetric information problems*, by providing expert advice to customers or assisting providers in risk assessment, portfolio and risk-based remuneration schemes are particularly useful. In the case of recurring commissions on a portfolio, intermediaries participate in the risk of mis-selling or misadvice, because cancellations by consumers reduce remuneration linked to the portfolio.

14 DG Internal Market and Services, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H), Contract ETD/2007/IM/H3/118, Final Report by Europe Economics London, 2009, p.35.

Table 1: Incentive effects of remuneration schemes: ++ high, + medium, 0 zero, - negative (conflict of interest)

PRIMARY TASK REMUNERATION SCHEME	MARKET MATCHING	ALLEVIATE ASYMMETRIC INFORMATION	
		ex ante	ex post
Initial/volume-based commission	++	-	-
Portfolio/risk-based c.	+	++	++
Profit-based c.	+	+	+
Fixed fee or salary	0	0	0

Source: iff own presentation

Volume-based sales commissions, by contrast, are not suited to intermediaries whose primary task is to solve ex ante asymmetric information problems, because they provide incentives to conclude contracts, but not to recommend products that are in the consumer's best interest or to disclose the risk associated with certain products. High first-year commissions engender incentives for "twisting", i.e. replacement rather than renewal of policies (for evidence see Chapter 1).¹⁵ Volume-based sales commissions thus create conflicts of interest between the maximisation of the intermediary's profits and long-term customer satisfaction for intermediaries, whose main task is to provide adequate advice to customers.

If ex-post substitutability of products is high, customers and suppliers benefit from back-end loading, i.e. remuneration of the intermediary for his post-contractual or contract renewal efforts (portfolio or risk-based commissions).¹⁶ Our survey shows that consumers have particular difficulty with the evaluation of capital life insurance savings plans due to their complex rules. A survey of intermediaries in European credit markets shows that volume-based commissions create potential conflicts of interest in particular in the residential mortgage market and in relation to other consumer loans¹⁷. Our survey shows that this is also the case in consumer insurance and in particular the capital life insurance market. Potential conflicts of interest are less severe in the business finance sector, because the information advantage in favour of intermediaries is lower.¹⁸ The same applies to business insurance markets.

The (in)dependence of the intermediary from the supplier has a decision dimension and an incentive dimension. Decision independence refers to the ability of the intermediary to find the best product for the customer in the absence of distorting incentives. Incentive independence is high if the intermediary does not receive payment for recommending the

15 Regan, L. and Tennyson, S., Insurance Distribution Systems, in: The Handbook of Insurance, Georges Dionne (ed.), 2000, Chapter 24, p.31.

16 Aschenbrenner von Dahlen, S. and Napel, S., Insurance Intermediation – Theoretical Analysis and Practical Issues in the European Market, Zeitschrift für die gesamte Versicherungswissenschaft, 93, 2004, p.87.

17 DG Internal Market and Services, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H), Contract ETD/2007/IM/H3/118, Final Report by Europe Economics London, 2009, p.33.

18 DG Internal Market and Services, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H), Contract ETD/2007/IM/H3/118, Final Report by Europe Economics London, 2009, p.57.

product of a specific provider, or different levels of commission by different providers, and if there are no (cross-) shareholdings between provider and intermediary.¹⁹

Figure 2 above also illustrates how the intermediary is tied to a single provider by a contractual relationship (exclusive agent), but can have multiple principal-agent relationships with several providers (agent linked to multiple suppliers or broker who works on behalf of several suppliers). Non-tied intermediaries have higher decision independence, but their incentive independence may be lower. Multiple agents or brokers are incentivised to guide consumers towards the products of the provider that offers the highest remuneration, even if this is not the best fit for the consumer. Competition between providers therefore drives the level of commissions up.

Exclusive agents can use the detailed product information gained from their relationship with one supplier to guide the consumer towards products that are not in the consumer's best interest. Volume-based sales commissions misalign their incentives towards extensive sales or sales of expensive and non-competitive products. Evidence from credit intermediaries shows that activities aimed at reducing consumers' ex ante asymmetric information problems are more prevalent among tied intermediaries, which are therefore most prone to conflicts of interest arising from volume-based commissions.²⁰

The risk of a conflict of interest between short-term profit maximisation and long-term customer satisfaction is higher for tied and linked intermediaries, bancassurance and retailers than for brokers and advisers. For residential mortgage and investment markets it has been shown that tied intermediaries tend to recommend non-competitive products or overcharge customers more often, while non-tied intermediaries recommend inappropriate products more often, probably because they have less product knowledge or their commissions are driven up by competition (Our survey finds that overcharging due to high commissions is also a problem in payment protection insurance sold by banks).

Further conflicts of interest arise for tied and linked intermediaries if they are obliged to offer product bundles or tied products, whereby suppliers can increase their market power and extract a higher surplus from customers. Bundling and tying increase information asymmetry to the detriment of consumers, because they make price comparisons more difficult. An example of tying would be that the availability of a particular credit product is conditional upon the purchase of credit insurance. In the case of bundling, the supplier refuses to sell one of two products separately ('pure bundling') or it does sell the products individually but offers a discount or other benefits when they are bought together ('mixed bundling' or 'commercial tying').²¹

19 Aschenbrenner von Dahlen, S. and Napel, S., Insurance Intermediation – Theoretical Analysis and Practical Issues in the European Market, *Zeitschrift für die gesamte Versicherungswissenschaft*, 93, 2004, pp.92.

20 DG Internal Market and Services, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H), Contract ETD/2007/IM/H3/118, Final Report by Europe Economics London, 2009, p.33.

21 DG Internal Market and Services, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H), Contract ETD/2007/IM/H3/118, Final Report by Europe Economics London, 2009, p.41.

Summary

Table 2 gives an overlook over the different theoretical and empirical findings as to the main economic contributions of intermediaries and potential conflicts of interest due to volume-based commissions in consumer financial markets.

Table 2: Contribution of intermediaries and potential conflicts of interest due to volume-based sales commissions in consumer financial markets

PRODUCT	ECONOMIC CONTRIBUTION	TO CUSTOMERS	TO PRODUCERS	POTENTIAL CONFLICT OF INTEREST
Credence goods (long-term contracts, high information asymmetry), e.g.: -Capital Life insurance -Residential Mortgage -Long-term/complex investments	Market matching Alleviate ex ante information asymmetry	very high very high	very high very low	very high
Products with medium information asymmetry, e.g.: - Private health insurance - credit insurance -other consumer credit	Market matching Alleviate ex ante information asymmetry	medium medium/high	high low/very low	high
Standardised products (low information asymmetry), e.g.: - Car liability insurance - point of sale credits	Market matching Alleviate ex ante information asymmetry	medium low/medium	very high low	Low/absent

Source: own composition, DG Internal Market and Services, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H), Contract ETD/2007/IM/H3/118, Final Report by Europe Economics London, 2009, p.57.

1. Volume-based sales commissions create conflicts of interest between profit maximisation and customer satisfaction for intermediaries (tied and non-tied) whose main task is to provide expert advice to customers.
2. Potential conflicts of interest are greatest in the credence goods markets such as capital life insurance (endowment policies), residential mortgages and complex investments.
3. Potential conflicts of interest are greater for tied and linked intermediaries, banks and retailers than for brokers and advisers.
4. Volume-based sales commissions lead to neglect of advice in favour of sales (bias to sell) and unnecessary redeployment of portfolios.
5. Volume-based sales commissions lead to recommendations of uncompetitive products or overcharging of customers (bias to increase prices), in particular by tied intermediaries and bancassurance, because these make only a limited market searching contribution or are forced to sell products in conjunction with the supply of other products (e.g. credit insurance offered by a bank associated with a loan).
6. Volume-based sales commissions lead to recommendations of inappropriate insurance products (product bias) and inappropriate insurers (provider bias), in particular by "brokers" that are in fact linked agents, because these have less product knowledge or recommend the product of the supplier that pays the highest commission. This is especially problematic if commissions are driven up by competition between suppliers, and "brokers" hold large market shares (e.g. Ireland, see Figure

13 on p.32) and if consumers are more inclined to follow the their advice because they think they are independent.

1.3.2 Legal perspective: Personal dependencies and customer interest

Article 17 (1) IMD II²² regulates *Conflicts of interest and transparency* and describes the conditions under which potential conflicts may occur which justify increased transparency requirements.²³ The following factors should be taken into consideration:

(d) the nature of the remuneration received in relation to the insurance contract; (e) whether in relation to the insurance contract, it works: on the basis of a fee, that is the remuneration paid directly by the customer; or on the basis of a commission of any kind, that is the remuneration included in the insurance premium; or on the basis of a combination of both (i) and (ii); (f) ... the intermediary will receive a fee or a commission of any kind; (g) ... the amount of the commission is based on the achievement of agreed targets or thresholds relating to the business placed by the intermediary with an insurer (...).

The Member States surveyed have not yet developed a consistent set of definitions of conflicts of interest in financial intermediation.

In **France**, there is no general legal definition of a conflict of interest. Article L520-1 of the Insurance Code imposes an obligation to disclose whether or not the intermediary is subject to exclusivity or not in its product recommendations.²⁴

In **Ireland**, this issue attracts only limited provisions, other than provisions on transparency of remuneration. Those provisions are, however, comprehensive and contained in the Central Bank's Consumer Protection Code 2012.²⁵

In **Spain**, while comprehensive provisions exist to avoid conflicts of interest for investment firms, there is no direct reference in the legislation to insurance intermediaries. However, insurance brokers (independent insurance intermediaries that must act in accordance with the interests of the policyholders, insured parties and beneficiaries), must inform the Authority in charge of any close link with individuals or corporate bodies. This information must be given in order for the authority to assess whether this "close link" could in any way impair the independence of the insurance broker.²⁶

Poland and **Slovenia** also have provisions scattered across a number of sources.

22 Please remember that references to IMD II and MiFID II are to legislations in the proposal/negotiation stage early 2013.

23 Where these conditions are identifiable Article 17 (1) requires disclosure of (f) ... the full amount of the remuneration concerning the insurance products being offered or considered or, where the precise amount is not capable of being given, the basis of calculation of all the fee or commission or the combination of both; (g) ... the targets or thresholds as well as the amounts payable on the achievement of them.

24 See Article L520-1, available online: http://www.legifrance.gouv.fr/affichCodeArticle.do;jsessionid=210A0CF3DF6FC75E18A418E223EEC2AF.tp djo05v_2?idArticle=LEGIARTI000020195159&cidTexte=LEGITEXT000006073984&dateTexte=20130507.

25 See Provisions 3.28 to 3.36 General Requirements. Section 3.28 states: 'A regulated entity must have in place and operate in accordance with a written conflicts of interest policy appropriate to the nature, scale and complexity of the regulated activities carried out by the regulated entity. The conflicts of interest policy must: a) identify, with reference to the regulated activities carried out by or on behalf of the regulated entity, the circumstances which constitute or may give rise to a conflict of interest entailing a risk of damage to the interests of its customers who are consumers; and b) specify procedures to be followed, and measures to be adopted, in order to manage such conflicts'. The Code is available online: <http://centralbank.ie/regulation/processes/consumer-protectioncode/Documents/Consumer%20Protection%20Code%202012.pdf>.

26 See article 28 Act 26/2006.

In **Denmark**²⁷ 'it is required that the broker only represent the customer and may not have any direct or indirect connections with an insurance company that are likely to place doubt on the independence of the broker from insurance company interests'.

Italy also possesses a comprehensive set of rules on conflicts of interests, some of which derive from case law (now enshrined in legislation, Article 50 of Regulation n°5/2006 and Articles 51-52 of Regulation 35/2010) following concerns in relation to insurance as collateral for credit and mortgage contracts. Article 183 (c) of the Code of Private insurance also contains provision on conflicts of interests, imposing an obligation to make arrangements to identify and prevent conflicts where possible and inform clients of their existence when they cannot be avoided.

In the **United Kingdom**, conflicts of interest are primarily dealt with under the general law as to the fiduciary obligations of agents and under specialist legislation. Agency law in England includes a reasonably robust 'secret commission' doctrine which requires the agent to obtain his/her principal's (customer's) informed consent to a situation of conflicting interest such as the payment of commission. Absent sufficient disclosure, the payment may be treated as a bribe and any related transaction may be set aside. As a result, the critical question is what information, and how much information, is the agent required to disclose? The law is unclear in this area, however. Courts have dismissed consumer claims and upheld insurance contracts in which there was no disclosure of intermediary commission (see for example *Harrison v. Black Horse*²⁸). By contrast in *Hurstanger v. Wilson*²⁹, the Court of Appeal held that in recognition of the vulnerabilities of consumers in non-status lending markets, a loan broker on commission must point out the conflict of interest. Specifically, the broker is required to inform consumers not only that a commission is to be paid but also the amount and the information should be presented in such a way as to make it clear that the broker seeks the consumer's consent.

Within the regulatory scheme, Principle 8 of the Principles for Business provides that "A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client". The Rules for the Conduct of Insurance Business (ICOBS) include guidance on the application of Principle 8 to inducements³⁰ and to claims handling.³¹ In addition, some rules applicable to all regulated activities are found in the Handbook chapters on "Senior Management Arrangements, Systems and Controls".³²

1.3.3 Sociological perspective: client – intermediary relationship and financial incentives

There is also a sociological dimension to the labour and income relationship between the intermediary and the supplier on the one hand and the relationship between the

27 Those included the Financial Business Act, article 72(2) and article 343j; the Executive Order on Investor Protection, art.11; the Act on financial advisers art.8 and the Insurance Intermediation Act, art.17.

28 [2011] EWCA (Civ) 1128.

29 [2007] EWCA Civ 299.

30 at s.2.3.

31 at s.8.3. Note that The Insurance Times reported on July 02, 2013, that the FCA is launching a thematic review of broker business models and conflict of interest. This review seems to be focusing on the impact of changing business models of insurance mediation on SME and microbusiness customers, (<http://www.insurancetimes.co.uk/fca-confirms-probe-into-broker-conflicts-of-interest/1403352.article>), although such information could not be located on the FCA site.

32 See in particular SYSC10 Conflicts of Interest, available at: <http://media.fshandbook.info/content/FCA/SYSC/10.pdf>.

intermediary and the consumer on the other. Intermediary and supplier compete for the return derived from a sale, but may also cooperate to increase joint profits and extract additional rents from consumers (so-called 'coopetition'³³). The remuneration system determines the division of the return and risk-sharing between intermediary and supplier, but may also facilitate collusion. The intermediary has an interest in a stable income, where the risk of low profit in certain areas and at certain times should be shifted to the supplier in return for recovery by the supplier of any higher profits. This problem has preoccupied labour law since the beginning of industrialisation. Trade unions successfully managed to stabilise the income of workers by gradually reducing its direct relationship to the outcome of their work. The success of the labour movement can even be measured by the increase in labour contracts with remuneration calculated solely pro rata tempore. But elements of *performance-related pay* in the form of *piecework*, of which volume-based commissions are merely an extreme expression, is still part of most labour contracts.³⁴ Performance-related pay shifts part of the risk back to the worker. It may cause unstable, unforeseeable and even insufficient income for certain periods. But it also provides incentives and efficiencies on the one hand, and opportunities for the employer to direct the work of the worker according to the needs of the enterprise on the other. It is thus seen in human resources departments as a motivational tool for reaching company targets and objectives.

While from a legal point of view intermediaries and tied agents may fall into different categories, in practice the amount of variable incentives paid to an insurance agent may be as high as what an independent broker may receive for the same product from the same provider. Since such incentives are especially topical in the context of financial services, a fourth dimension should be added to the general critique of such remuneration systems, namely the *stability of the income* of intermediaries. The mentioned survey as to the different categories of intermediaries selling investment products further revealed that a majority assumed that *their freedom to promote products which they themselves found appropriate* (auto-determination at work) was restricted. Their own long-term perspective as to their clients' needs was limited more by the short-term perspective imposed by the sophisticated systems of variable financial incentives than the direct instructions and guidelines of their superiors.

Empirical surveys of intermediaries have shown³⁵ that the vast majority of sales persons in investment services feel uncomfortable with volume-based incentives. In a survey of investment advisors in Hamburg³⁶ conducted with the staff of 67 bank and direct marketing agencies, 95% of the advisors indicated that they wished they were able to put their clients' interests first. But 80% revealed that they found themselves squeezed between short-term sales success and long-term client advantage. More than half reported that they were under great pressure to neglect the long-term interests of their clients. 37% declared that they, knowingly, have already sold products to clients that did not suit their situation or goals. There was also a significant difference between banks, where advisors admitted to far more constraints, and direct marketing agencies.

33 Aschenbrenner von Dahlen, S. and Napel, S., Insurance Intermediation – Theoretical Analysis and Practical Issues in the European Market, Zeitschrift für die gesamte Versicherungswissenschaft, 93, 2004, p.87.

34 Lagace, Martha "Pay-for-Performance Doesn't Always Pay Off". Harvard Business School Working Knowledge. April 14, 2003; Heinz-Peter Kieser: Variable Vergütung im Vertrieb. 10 Bausteine für eine motivierende Entlohnung im Außen- und Innendienst 2012.

35 Hoffmann, T. Anreiz orientierte Aufsicht über Wertpapierdienstleister, Wiesbaden 2009

36 Mayer-Fiedrich, Verbraucher und Recht ****

Selection processes may have played a significant role in this, however, since advisers were only selected if they stated that they would put clients' interests first. The possibility of an additional conflict of interest between intermediary and supplier must also be taken into account.

2 Remuneration: Which models are prone to create a conflict of interest?

In this part, the report explores models of remuneration, the markets for life and non-life insurance, and a range of different commission based remunerations. The advantages and disadvantages of remuneration systems are also assessed from a range of perspective.

In this part the notion of remuneration is taken to have the same meaning as the one given in Article 2 (18) IMD II which defines '**remuneration**' as *any commission, fee, charge or other payment, including an economic benefit of any kind, offered or given in connection with insurance mediation activities*. This covers all incentives with a direct advantage that has a certain money value and which, according to Article 2(5), have a causal link to the intermediation. With regard to the different forms of remuneration the law singles out This section will also explore a number of alternate remuneration types.

2.1 Models of Remuneration

Remunerations have different functions for intermediaries. They are a source of income and they contain incentives to produce the gain the provider is expecting from this kind of intermediation.

Remuneration systems can be defined by the incentives they provide to act in favour of a provider's interest.

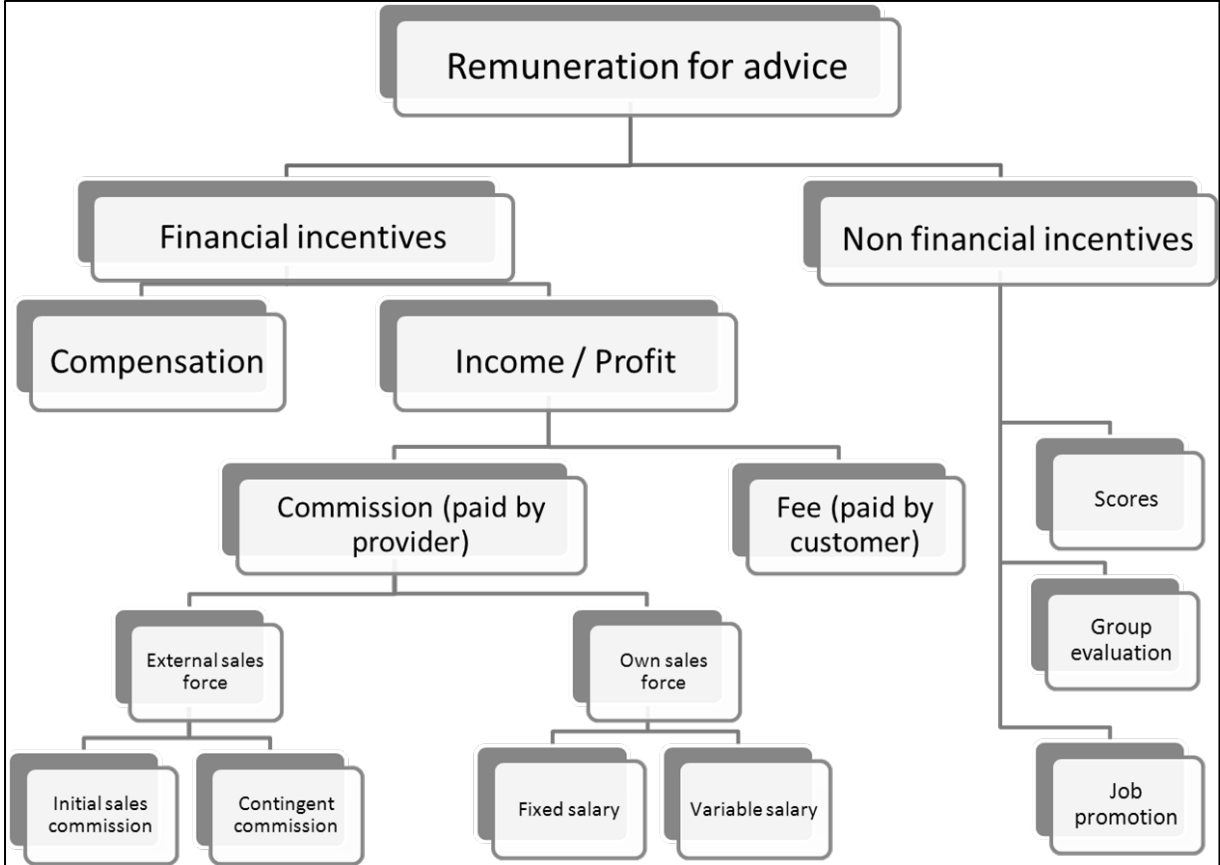
- **Direct incentives** are commissions linked to specific products or/and the amount of sales either by piece but mostly by value.
- **Indirect incentives** have immediate or long-term effects on the income the salesperson gains from the supplier.
 - It can comprise a score system where the salesperson gains points.
 - It can be a ranking, which is disclosed, and has immediate status effects, but also long-term effects (such as promotion – especially in so-called structural marketing).
 - It can be used to build the basis for management decisions concerning income and promotion.
- **Fees** paid by the customer usually represent the time invested by the independent advisor to consult on the financial situation of the customer. This form of remuneration is typically unlinked to the gains the supplier expects from the sale of his goods or services.
- **Charges directly to the consumer** exist in investment and some instalment credit, especially on the Internet.³⁷

The following graph tries to systematise the different ways to remunerate intermediaries. But it should be noted that remuneration also needs to include non-financial incentives that may also result in financial gains (e.g. job promotion, job security). Non-financial

³⁷ See Wikipedia.de for „Onlinemakler“. One online broker describes his service as follows. Consumer acquire a fee based ServiceCard. They then go online to the website of the broker where they are admitted with their card. The online broker gives an overlook on products and prices which he claims are much cheaper than usual. This is all stored in a personalised section. Also information about the behaviour of the insurer in cases when the risk insurance has to pay are available. The discussion on forums on the Interest show split opinions but it is not clear because many discussants confound commission based brokers who as they say insist on ever renewed new contracts (to earn commissions) with fee based online brokers as the one described.

incentives tend to be more long-term incentives compared to commissions earned as a policy is signed (short-term). Exploring long-term incentives may offer a set of solutions persuading intermediaries to shift their remuneration models.

Figure 3: Remuneration models from an intermediary's perspective



Source: iff own graphic representation.

The Table gives an overview of the building blocks of remuneration³⁸ in the financial services industry.

38 Please note that throughout this research we use the term remuneration. This is the equivalent of the US word "compensation" which in British English is used to refer to rectification or redress and not reward.

Table 3: Traditional forms of remuneration

VARIABLE	PAID BY	PAID TO	LEGAL FORM	DESCRIPTION
Fixed	Supplier	employee, agent, broker	salary	Traditional way of compensating primarily the employees of a company. The income of the sales staff is based on a labour contract, paid in equal proportions throughout the year.
	Customer	agent, broker	fee	The customer pays a fixed (hourly) fee for advice to an intermediary (agent, broker).
Variable	Supplier	employee, agent, broker	Salary bonus	In addition to a fixed salary, a variable remuneration (bonuses) depending on performance and/or commission amounts and percentages based on different performance measures vary by company. Employees/ agents may be required to maintain a certain performance level to continue receiving commission percentages. Remuneration will decrease if quotas are not met.

While these traditional forms of remuneration have little potential to incentivise intermediaries to sell unfit and unnecessary insurance to the customer, the main problem seems to lie with what is called a *contingent commission*. A '*contingent commission (...)* is where the amount payable is based on the achievement of agreed targets relating to the business placed by the intermediary with that insurer' according to Article 2 (10) IMD II.

In the insurance industry, they are based in principle on two performance measures: volume- and/or profit.

- Profit-based contingent commissions adjust with changes in the insurer's profitability.
- Volume-based commissions vary depending on the amount of business that a particular employee/agent generates for the insurance company.

The following table gives an overlook on the different forms of contingent commissions.

Table 4: Contingent commissions

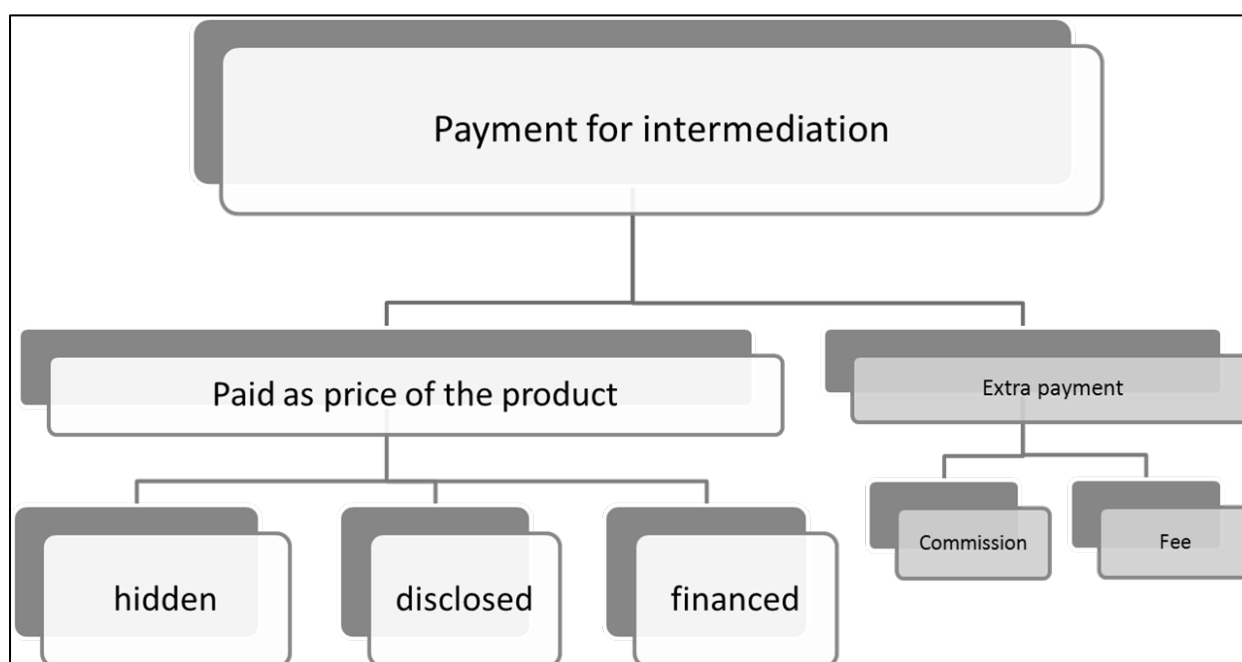
PAID	BASED ON	EXPLANATION
initially	sales	After the successful sale of an insurance product, regardless of the specific type of policy, the agent who is responsible for acquiring the new client and closing the deal will be paid an immediate commission. The type of policy sold will determine how much commission is earned, and different lines of insurance pay higher or lower percentages.
recurring	portfolio (trails)	Remuneration for assisting clients, insurance companies pay residual commissions, called " trails ," to the agent who initially sold the policy. On the client's policy anniversary date, the insurance carrier will pay the annual renewal commission percentage. In life insurance agents may choose a larger initial commission in exchange for a very small, or non-existent, residual trail, or a reduced up-front pay-out in exchange for a larger trail. Other types of insurance, typically health insurance and related employee benefit policies, pay sales agents a minimal up-front commission and continue to pay the same amount every month. This method of remuneration is called " as-earned " and serves to protect the insurance carrier from paying larger up-front commissions on policies that may not remain in force for the entire year. As-earned commissions are advantageous to the insurance sales agent because they can effectively create a regular monthly salary.
when risk occurs	risk	In the case of commissions linked to contract cancellations, claims, defaults or missed payments by consumers, the sales agent participates in the risk of the provider or the risk of mis-selling or false advice.
variable	transaction volume	The customer pays a variable fee for advice to an intermediary (agent, broker) depending on transaction volume or product.

This table concerns only such benefits which are paid in the form of money.

Benefits in kind, only have indirect effects. They are for example offered in the form of premium reductions, travel, training are awarded if employees/agents meet or exceed predefined sales goals and production quotas. It is not uncommon for employees to be invited to luxurious holidays, meetings in foreign countries or five star hotels as well as trips to resorts around the world. Those benefits have the advantage of providing opportunities for conspicuous consumptions for the intermediary, and for the supplier the possibility to use tax advantages. This kind of rewards are also used to form communities in which pressure to follow values is exercised by those who pay for these events.

While these incentives are transparent and visible for the intermediary, the customer is to a large extent, excluded from it. He or she can only understand the amount and impact of remuneration if it has to be paid separately by him or her. But, in those cases the remuneration is hidden in the price and premiums of the contract.

Figure 4: Visibility of remuneration models for customers



Source: iff own presentation.

Our survey results show that remuneration in the insurance industry takes many forms. It is not possible to point to a model of remuneration. Rather, the industry uses a variety of models.

Insurance *employees* are mainly remunerated by fixed salaries in Denmark and Italy. In France, they receive fixed and variable salaries that are not sales dependent as well as non-financial rewards.

Tied agents are remunerated by sales commissions based on the insurance premium (France, Italy) or profit of the insurance company (France). In Italy, contracts for tied and *linked agents* often provide for bonuses, according to the total amount of premiums collected, and with reference to the ratio accident/premium. In the Netherlands, the remuneration of tied agents depends on type of product: they receive a fee from the consumer for complex products and a commission for simple risk insurances. In Poland, tied agents are remunerated only by commissions. Linked agents receive a mix of contingent and portfolio commissions in Denmark and commissions in France that vary

according to the product and agent's tasks, but are mostly based on the insurance premium. Also in Poland, linked agents only receive commissions.

Brokers are solely or mainly remunerated by commissions in all countries where this is allowed. The amount depends on the scope of the task/service delivered to the insurance company and the product type. Our survey shows that volume-based commissions also prevail in *bancassurance* (e.g. France, mix of contingent and portfolio commissions in Italy and Denmark) and in distribution by *retailers* (e.g. France, Italy).

In France the upmost majority of *advisers* are remunerated by fixed commissions on insurance or financial products they sell. Only 0.5% of advisers use to be remunerated by advisory fees. In Italy, clients are free to determine fees for advisers. Contracts can provide that the remuneration is based on the assets involved as well as on the value of premiums paid. Even the codes of conduct do not set specific rules for that payment.

The models of commission payments also vary with the type of product. In Ireland, most products carry initial commission however trail is becoming more popular with investment products. In Italy, commission payments are determined on a certain percentage of the premiums collected. Generally, intermediary agreements provide for different percentages according to the lines of insurance involved (higher for life and some non-life lines, lower for motor insurance and other compulsory insurances). In Germany commissions in life insurance are higher than in non-life, where they vary with the insurance line. Own calculations show that 93-94% of total commissions in German life insurance are sales commissions, while in German health insurance the market share of sales commissions reaches 72-80%. (see chapters 2.3 and 2.3.2).

However, fee-based models are structured in different ways. In Denmark, brokers have a wide range of methods to calculate the fees that the customers are charged. In Denmark, Ireland and the Netherlands, there is a mix of hourly and fixed fees. In France, mostly fixed fees are used. In Italy, fees are generally determined on hours as well as on premium levels (Survey answers A2).

In Denmark and Finland, independent brokers are allowed to receive fees from their customers only.

2.2 Distribution of retail insurance in the EU

In this section, the report brings together data to provide an impression about the importance, allocation and spread of the problems linked to remuneration. Unfortunately, aggregate data which could directly inform about the amount of commissions earned from consumers through the remuneration schemes in question covering the whole of the EU are not available. The data provided country by country from respondents to the questionnaire remain scattered and reflect that only a few countries have investigated these issues. In any event, the data is often incomparable and reflect the differences in the use of financial services per country.

The report has therefore drawn on other sources to build a picture of the markets for insurance.

We have put special focus on life insurance where according to the responses as well as the existing regulations the core of the problems with intermediation lies. Where possible we have juxtaposed these data with the residual forms of retail insurance.

Our research illustrates that the problem of insurance intermediation in life insurance has an enormous impact on the economy as well as on consumers in the EU. This market will

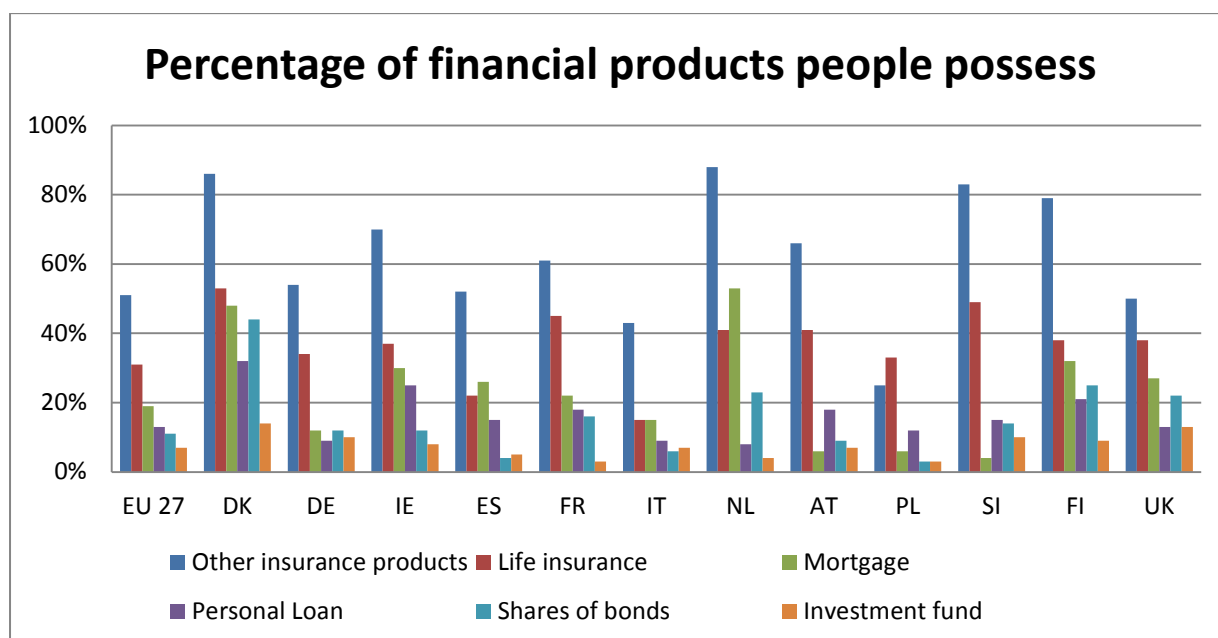
increase in the next years, especially in those countries with a low penetration in financial services.

Life insurance plays a large role in individual financial planning, with population coverage of 98.71% and annual premiums per inhabitant of 934 Euro³⁹ over the whole of Europe. Therefore, welfare losses to consumers are likely to be large, if the wrong life insurance products are sold due to commission-based remuneration of intermediaries.

But the problems are not yet evenly spread throughout Europe due big differences in the use of financial services. There are at least three groups of countries which should be distinguished: countries with an advanced use of financial services (for example the UK, Ireland, Denmark and the Netherlands), countries where these services are still underdeveloped (especially in the new accession countries like Poland and Slovenia and the central European) and Northern states (such as Germany, France, Italy, Spain and Finland) which could be situated in between. These groups apply also different market philosophies and have different regulatory approaches which can be attributed to the state of their development and their market forms.

This picture is also visible in the overall use of financial products in the EU. Figure 5 illustrates the results of a 2011 survey of 26,856 European citizens aged 15 and above regarding the use of insurance, credit and investment products for our sample of 12 member states. It shows that insurance is the most important financial product for consumers in all countries. In most member states, at least a third of the respondents have a life insurance and at least half of them have non-life ('other') insurance products, such as health, car or home insurance.

Figure 5: Use of insurance, credit and investment products (2011)



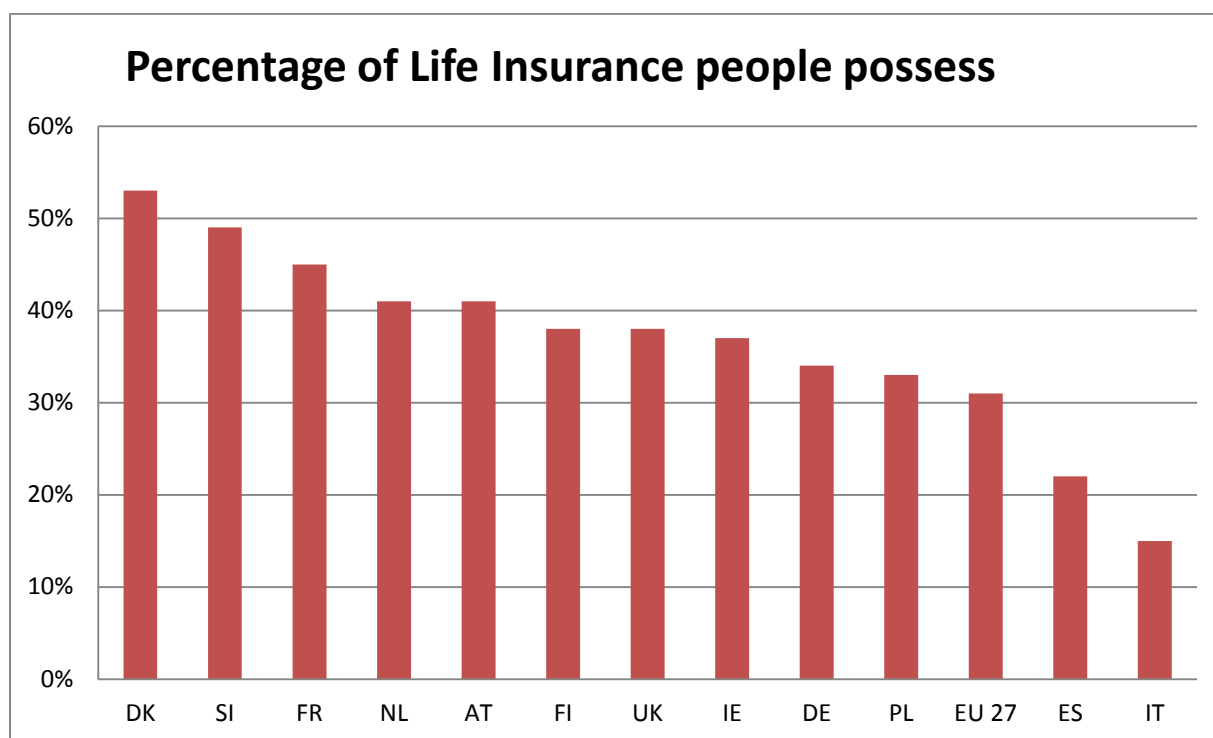
39 See Table Life insurance data in Europe 2011.

Source: European Commission, Special Eurobarometer 373, Retail Financial Services, 2012, p.13, own composition.

2.2.1 Life insurance markets

In 2011, European life premiums totalled €618bn, 70% of which are from the four largest markets - the UK, France, Germany and Italy. The ratio of life premiums to total premiums amounts to 58%. It ranges from 8% in Iceland to 78% in Ireland. In the sample of the 12 selected member states, this ratio is lowest in Finland (17%), followed by the Netherlands (28%) and Slovenia (29%), and second highest in Denmark (76%). In the four largest markets it ranges from 47% in Germany to 66% in France, 67% in Italy and 73% in the UK.⁴⁰

Figure 6: Use of life insurance (2011)



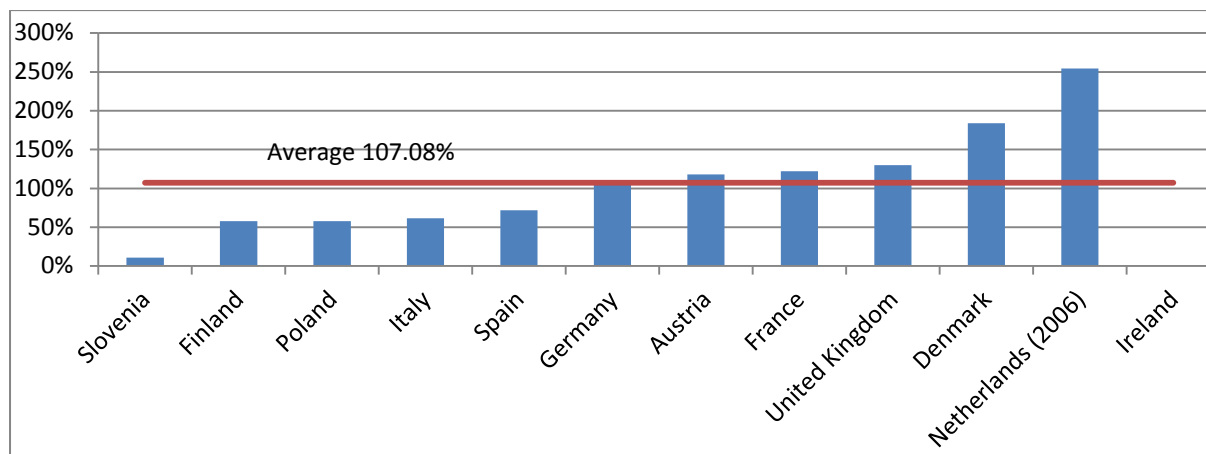
Source: European Commission, Special Eurobarometer 373, Retail Financial Services, 2012, p.13, own composition.

Population coverage

Figure 7 shows the number of life insurance contracts per inhabitant for the 12 selected member states (except Ireland) in 2011. For the Netherlands data after 2006 are not available. The average population coverage across the 12 countries is 107.08%, because there is more than one contract per inhabitant.

40 Insurance Europe (2013b): The European Life Insurance Market in 2011. CEA Statistics No. 47, 2013.

Figure 7: Population coverage (number of life contracts to total population ratio) 2011, in per cent



Notes: For the Netherlands, data refers to the number of policies and includes both saving funds and individual policies. For Slovenia, data refers to the number of policies (and not contracts). Source: Insurance Europe (2013b): The European Life Insurance Market in 2011. CEA Statistics No. 47, 2013; Eurostat (2013a): Population on 1st January, 2001-2012; own composition.

The country with the lowest population coverage is Slovenia, where not even 11% of the population possesses life insurance. By contrast, in the Netherlands each inhabitant has on average 2.5 life insurance policies.⁴¹ From the perspective of the whole Europe, population coverage is highest in Sweden with 473.15%, which is nearly five times the European average.⁴² The cross-country differences may partly be explained by differences in the pension systems with a different role of the 'third pillar', which comprises individual pension plans through capital life insurance. In a sample of 11 European countries (Austria, Germany, Sweden, Denmark, France, Italy, Spain, Switzerland, the Netherlands, Belgium and Greece) of individuals aged 50 and older, the ownership rate of individual retirement accounts was highest in the Scandinavian countries (Sweden 46%) and Denmark (43%) and lowest in Spain (10%), Italy (75) and Greece (5%), and varied between 24% and 35% in the other countries.⁴³

These findings of a large importance of the life insurance market are supported by empirical studies about individual savings behaviour. Bonis et al. (2012) found that for some OECD countries, including France, Germany, Italy, Spain and the UK, life insurance investments reached a higher share of GDP than investments in investment funds and bond funds in 2009 and increased significantly since 2000 in almost all Continental European countries.⁴⁴ Therefore, disparities in population coverage across Europe are lower for life insurance than for other financial products (Christelis et al. 2005, p.11).⁴⁵

41 However note that the data for the Netherlands cannot be directly compared to that of the other member states, because it refers to another year and to the number of policies, including both saving funds and individual policies.

42 See table Life insurance data in Europe 2011.

43 Le Blanc, Julia (2011): The third pillar in Europe. Institutional factors and individual decisions. Frankfurt am Main: Dt. Bundesbank (Discussion paper / Deutsche Bundesbank Eurosystem Ser. 1, Economic studies, 09/2011), p.8-9.

44 Bonis, R. de; Fano, D.; Sbano, T. (2012): Household Wealth in the Main OECD Countries from 1980 to 2011: What Do the Data Tell Us? Working Party on Financial Statistics. Directorate for Financial and Enterprise Affairs, p.25.

45 Christelis, Dimitrios; Jappelli, Tullio; Padula, Mario (2005): Wealth and Portfolio Composition in SHARE - The Survey of Health, Ageing and Retirement in Europe. Working Paper No. 132. Centre for Studies in Economics and Finance.

Public data does not break down life insurance into capital life and risk life. According to our survey results, the gross premiums written in capital life insurance range from 1,365 mln in Finland to 19,868 mln in Germany (see survey answers Q8-25 in Material). By relating these to the gross premiums in total life insurance (see Table 5), we calculate market shares of 44% for Finland and 24% for Germany.

Table 5: Life insurance data, Europe 2011⁴⁶

COUNTRIES	POPULATION	TOTAL COMMISSION	NEW CONTRACTS	TOTAL CONTRACTS	NEW PREMIUMS	TOTAL GROSS PREMIUMS	POPULATION COVERAGE	TOTAL GROSS PREMIUMS PER CAPITA	TOTAL GROSS PREMIUMS PER CONTRACT	TOTAL COMMISSION / TOTAL GROSS PREMIUM P.A.	TOTAL COMMISSION PER CONTRACT	GDP PER CAPITA	TOTAL GROSS PREMIUMS/GDP
	(in thousands)	(Euro millions)	(in thousands)	(in thousands)	(Euro millions)	(Euro millions)	(in %)	(in Euro p.a.)	(in Euro p.a.)	(in %)	(in Euro p.a.)	(in Euro p.a.)	(in Euro p.a.)
Austria	8,404	138	2,119	9,914	n.a.	6,988	117.97 %	831	705	1.97%	14	35,700	2.33%
Belgium	11,001	54	n.a.	n.a.	7,017	18,309	n.a.	1,664	n.a.	0.30%	n.a.	33,700	4.94%
Bulgaria	7,369	n.a.	416	n.a.	47	119	n.a.	16	n.a.	n.a.	n.a.	5,200	0.31%
Cyprus	840	n.a.	61	607	46	385	72.28%	458	634	n.a.	n.a.	21,100	2.17%
Czech Republic	10,487	26	n.a.	6,485	1,306	2,685	61.84%	256	414	0.95%	4	14,800	1.73%
Croatia	4,412	n.a.	309	1,413	70	327	32.02%	74	231	n.a.	n.a.	10,400	0.71%
Denmark	5,561	31	n.a.	10,224	n.a.	16,617	183.87 %	2,988	1,625	0.19%	3	43,200	6.92%
Estonia	1,340	8	84	718	n.a.	157	53.59%	117	219	4.95%	11	11,900	0.99%
Finland	5,375	81	256	3,100	257	3,073	57.67%	572	991	2.62%	26	35,200	1.62%
France	65,048	1,682	5,178	79,353	n.a.	124,476	121.99 %	1,914	1,569	1.35%	21	30,700	6.23%
Germany	81,752	6,312	6,310	89,729	27,948	83,188	109.76 %	1,018	927	7.59%	70	31,700	3.21%
Greece	11,310	267	520	7,627	184	2,202	67.44%	195	289	12.13%	35	18,500	1.05%
Hungary	9,986	86	358	2,858	202	1,573	28.62%	158	551	5.45%	30	10,000	1.58%
Iceland	318	0	n.a.	n.a.	n.a.	21	n.a.	65	n.a.	2.20%	n.a.	31,700	0.21%
Ireland	4,570	1,310	292	n.a.	5,652	8,885	n.a.	1,944	n.a.	14.74%	n.a.	35,200	5.52%
Italy	60,626	727	4,512	37,413	45,575	73,869	61.71%	1,218	1,974	0.98%	19	26,000	4.69%
Latvia	2,075	n.a.	10	60	13	34	2.91%	16	563	n.a.	n.a.	9,800	0.17%
Lithuania	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	10,200	n.a.
Luxembourg	512	353	n.a.	n.a.	n.a.	888	n.a.	1,735	n.a.	39.71%	n.a.	82,100	2.11%
Malta	415	n.a.	63	277	110	209	66.63%	504	756	n.a.	n.a.	15,700	3.21%
Netherlands	16,656	614	3,366	41,526	3,843	21,891	254.23 %	1,314	527	2.80%	15	36,100	3.64%

46



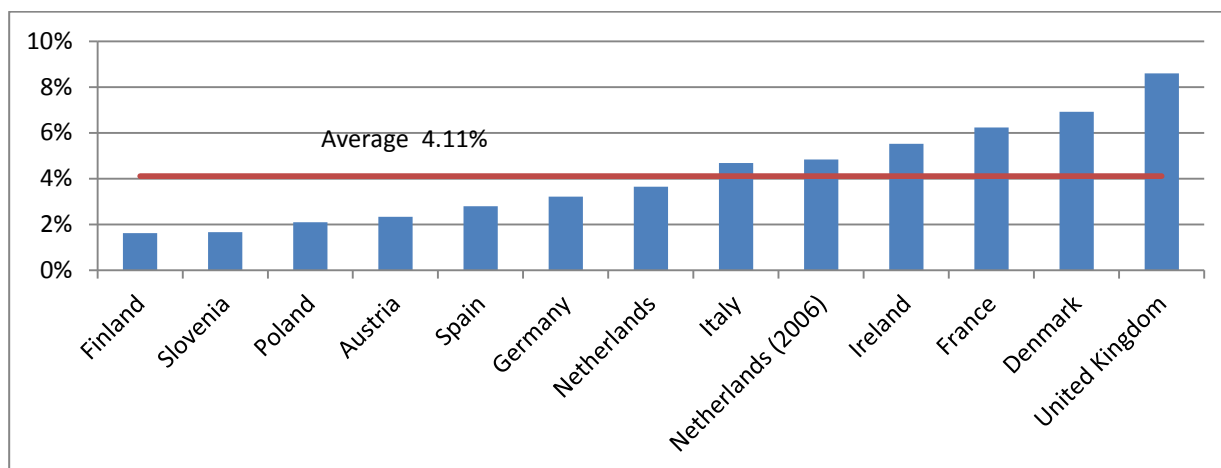
COUNTRIES	POPULATION	TOTAL COMMISSION	NEW CONTRACTS	TOTAL CONTRACTS	NEW PREMIUMS	TOTAL GROSS PREMIUMS	POPULATION COVERAGE	TOTAL GROSS PREMIUMS PER CAPITA	TOTAL GROSS PREMIUMS PER CONTRACT	TOTAL COMMISSION / TOTAL GROSS PREMIUM P.A.	TOTAL COMMISSION PER CONTRACT	GDP PER CAPITA	TOTAL GROSS PREMIUMS/GDP
ds							%						
Norway	4,920	262	375	7,412	812	9,237	150.64%	1,877	1,246	2.84%	35	71,200	2.64%
Poland	38,530	789	n.a.	22,337	n.a.	7,729	57.97%	201	346	10.21%	35	9,600	2.09%
Portugal	10,572	38	1,393	9,867	5,564	7,199	93.33%	681	730	0.53%	4	16,100	4.23%
Romania	21,414	n.a.	378	1,364	53	211	6.37%	10	155	n.a.	n.a.	n.a.	n.a.
Slovakia	5,392	26	513	9,480	428	1,094	175.80%	203	115	2.37%	3	12,700	1.60%
Slovenia	2,050	7	215	225	82	600	10.95%	293	2,672	1.16%	31	17,600	1.66%
Spain	46,153	n.a.	n.a.	33,171	n.a.	29,749	71.87%	645	897	n.a.	n.a.	23,100	2.79%
Sweden	9,416	379	1,367	44,550	4,970	22,955	473.15%	2,438	515	1.65%	8	41,000	5.95%
Switzerland	7,870	686	n.a.	6,284	n.a.	24,795	79.84%	3,150	3,946	2.77%	109	60,500	5.21%
Turkey	73,723	71	16,393	17,785	n.a.	1,143	24.12%	15	64	6.20%	4	7,500	0.21%
United Kingdom	62,499	5,535	6,274	81,157	69,742	149,356	129.85%	2,390	1,840	3.71%	68	27,800	8.60%
Results	31	24	21	26	21	31	26	31	26	24	20	30	30
Europe (total)	590,596	19,481	50,761	524,935	173,921	619,962	2566.43%	28,961	24,502	129.37%	547	836,000	88.30%
Europe (average)	19,051	812	2,417	20,190	8,282	19,999	98.71%	934	942	5.39%	27	27,867	2.94%

Sources: OECD (2013): Dataset: Commissions in the reporting country 2002-2011. OECD.Stat.; Insurance europe (2013b): The European Life Insurance Market in 2011. CEA Statistics No. 47; Eurostat (2013a): Population on 1st January, 2001-2012; Eurostat (2013b): GDP and main components – respective prices. GDP to market prices in Euro per resident.

Penetration

Another indicator of insurance activity is insurance penetration, measured by total gross written premiums as a percentage of GDP (see Figure 8). For the 12 member states, the average penetration rate is 4.11% in 2011, which is 1.1 percentage points above the mean for the whole of Europe. This may be due to the low penetration in the East European countries (not included in our study, except Poland and Slovenia), in some South European countries as well as Austria, Norway and Luxemburg where life insurance penetration is below the average.⁴⁷

Figure 8: Life insurance premiums to GDP 2011, in per cent



Notes: For Finland, statutory pension insurance is not included. Data for the Netherlands also include the indirect insurance business.

Source: Insurance Europe (2013b): The European Life Insurance Market in 2011. CEA Statistics No. 47, 2013; Eurostat (2013b): GDP and main components – respective prices. GDP to market prices in Euro per resident; own composition

In contrast to the population coverage, the insurance penetration of the Netherlands (4.84% in 2006) is only slightly above the average of the 12 countries (3.64 in 2011). This may indicate that a comparatively high number of contracts with low insurance sums and correspondingly low premiums are written. However, this cannot be proved because data on the sums insured are not available. From Figure 8 we may conclude that life insurance plays the largest role in the UK and Denmark, measured both by number of contracts per inhabitant and premiums relative to GDP. This may explain why a ban on commissions in life insurance markets was seen as urgent so that it became already introduced in both countries (Denmark: 2006, UK: 2013).⁴⁸

Market concentration

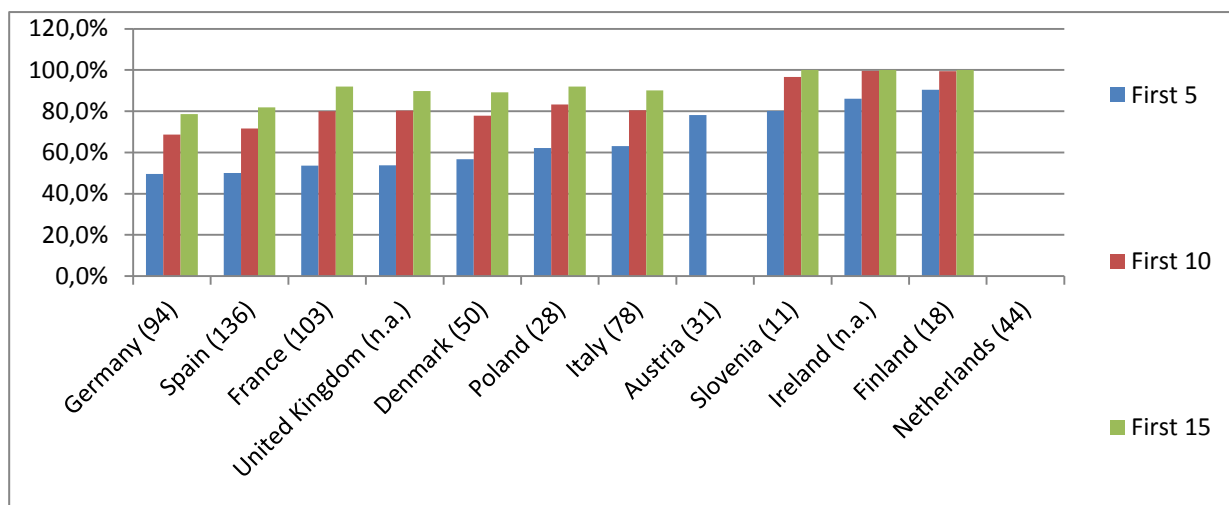
The intensity of competition in insurance markets may be a driver for the level of commissions. A usual indicator for a high degree of competition is a low market concentration, measured by the sum of the market shares of the largest companies. Figure 9 shows the market shares of the largest first 5, 10, and 15 life insurance groups in the 12

⁴⁷ See Table Life insurance data in Europe 2011.

⁴⁸ DFSA: Insurance Mediation Act No. 401. Consolidated Act no. 401 of 25 April 2007. GlobalDenmark Translations; Thorun, Christian, Niemyer, Frank (2012): Towards a fairer deal for consumers and the financial industry. Hg. v. ConPolicy GmbH und Prof. Roll & Pastuch GmbH. Association of German Fee-Only Advisers (BVDH) and quirin bank AG. Berlin. p.7.

member states in 2011. The numbers in parentheses indicate the total number of insurance companies in their respective country.⁴⁹ Market concentration is highest in Finland, where the largest 5 insurance groups collect 90.4% of the premiums. Our survey results show that the largest three providers already gather a market share of 80%. Since there are only 18 insurance companies, a market concentration of 100% is already reached by the largest 15 groups. Similar concentration rates can be observed in Ireland and Slovenia. In Germany, competition seems to be most intense. The number of life insurance companies (94) is lower than in Spain (136) and in France (103), but the group of five largest companies captures only 49.6% of the market, compared to 50% in Spain and 53.6% in France.

Figure 9: Market shares of the largest life insurance groups - 2011



Notes: The ranking is based on total life premiums on the national market. The definition of group perimeter may vary from country to country. For Denmark, the ranking includes foreign business. Source: Insurance Europe (2013b): European market operators – 2011, own composition.

Note that Italy has nearly three times as much life insurance companies as Poland, but similar concentration ratios. If the number of insurance companies coincided with the number of insurance groups, the degree of competition would be actually lower in Italy because of the higher number of firms. For each country, the maximum degree of competition would be reached if the premiums were distributed evenly among all companies. In this case, because of the low number of insurance companies, the market share of each individual company in Poland would be three times as high as in Italy. However, the 5, 10 and 15 concentration ratios are nearly identical in both countries, which indicates that the intensity of competition in Poland is actually higher than measured by the concentration ratio alone.⁵⁰

Therefore, the market share of the largest insurance groups is only a rough indicator of the degree of competition in a country.⁵¹

49 The number of insurance companies must not coincide with the number of insurance groups, because several companies are active under a common group name. Information about the exact number of the insurance groups is missing. Insurance Europe (2013b): European market operators – 2011.

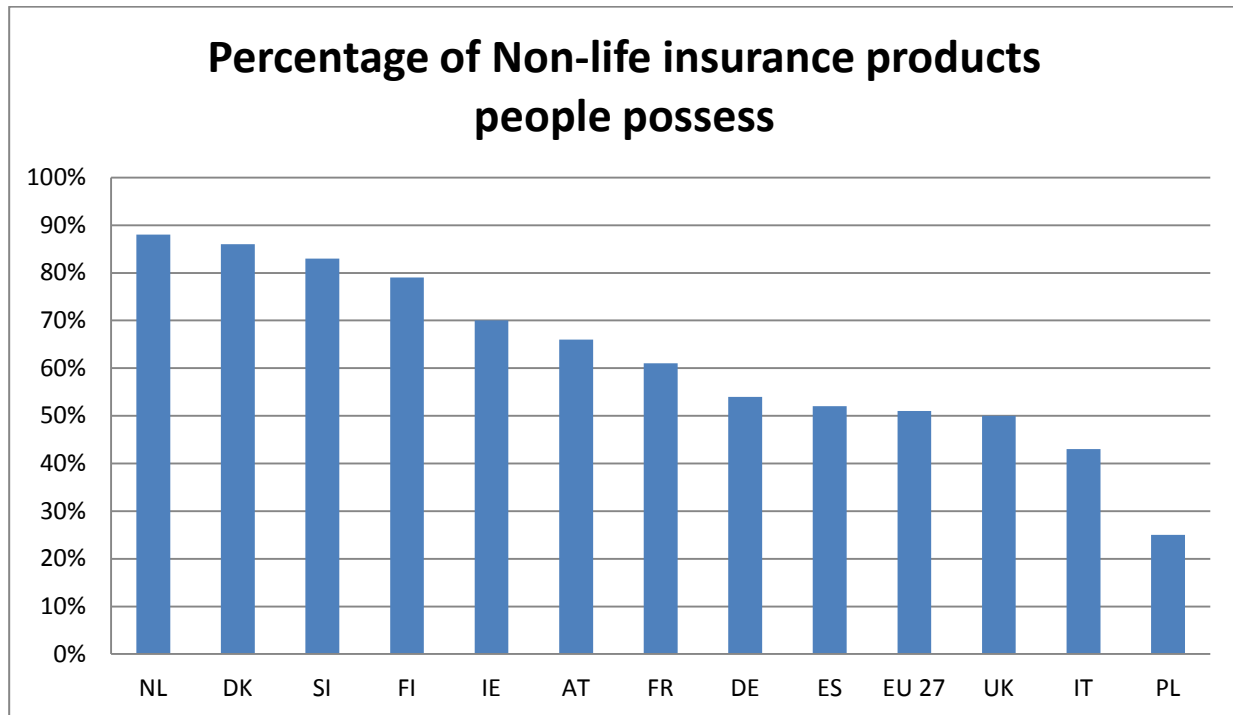
50 In the long-run equilibrium of a competitive market, the number of firms n increases with the size of the market under the assumption of constant fixed costs. If market shares are equally distributed, the market share of each firm is $1/n$. Therefore, market concentration declines with market size.

51 Public data about concentration ratios in the Netherlands are missing. According to our survey results, the largest three insurance companies have a market share of 46%.

2.2.2 Non-life insurance markets

According to the Eurobarometer survey about the possession of non-life insurance products in the EU, on average every second adult person has contracted risk insurance in the non-life area ranging from close to 90% in the Netherlands to little more than 20% in Poland.

Figure 10: Use of non-life insurance (2011)

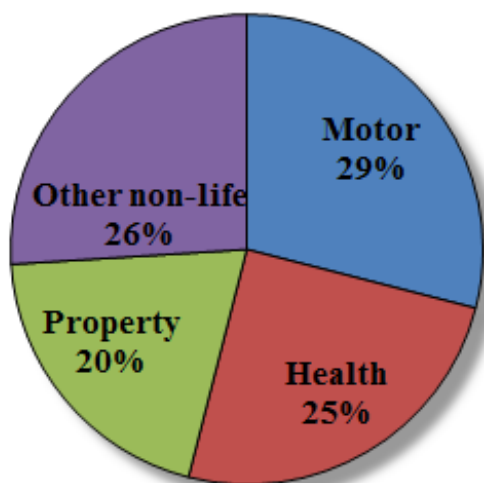


Source: European Commission, Special Eurobarometer 373, Retail Financial Services, 2012, p.13, own composition.

The largest non-life insurance markets in Europe are Germany, France, the UK, the Netherlands and Italy, which account for more than 70% of all European non-life premiums in 2011. The three main business lines are motor, health and property insurance with respective market shares of 29%, 25% and 20% (see Figure 11). The remaining 26% is distributed between general liability (7%), accident insurance (8%), marine, aviation & transport (4%), legal expenses (2%) and others including travel and credit insurance. In terms of premiums written, motor insurance is the largest non-life business in France, the UK and Italy, while private health insurance dominates in the Netherlands and Germany.⁵² However, in terms of population coverage, measured by number of contracts per inhabitant, car insurance also dominates in Germany. Our survey results show that in Germany, the number of contracts is 106.64 mln in car insurance and 68 mln in health insurance, which implies population coverage ratios of 1.3, respectively 0.83. Payment protection insurance plays only a minor role with 2,741,384 contracts, which implies that only 3% of the population uses this product.

⁵² Insurance europe (2013a): European Insurance in Figures 2013. CEA Statistics No. 46, p. 22.

Figure 11: Breakdown of non-life premiums — 2011



Source: Insurance Europe (2013a): European Insurance in Figures 2013. CEA Statistics No. 46, p. 22.

With regard to health insurance, the European private health insurance market is mainly driven by the Netherlands and Germany, which respectively represent 36% and 31% of the market in terms of premiums. Health insurance density and penetration differ significantly across countries due to differences in national health insurance systems. In 2011, health premiums per capita amount to 2400 Euro in the Netherlands, 424 Euro in Germany and just over 200 Euro in Slovenia and Austria. The remaining countries of our sample have health densities below the European average of 190 Euro. Also the ratio of health premiums to GDP in 2011 is highest in the Netherlands (6.7%), followed by Germany (1.3%) and Slovenia (1.2%). Slovenia is the only eastern European market with a health insurance penetration ratio above the European average.⁵³

2.3 Distribution of commission based remunerations in the EU

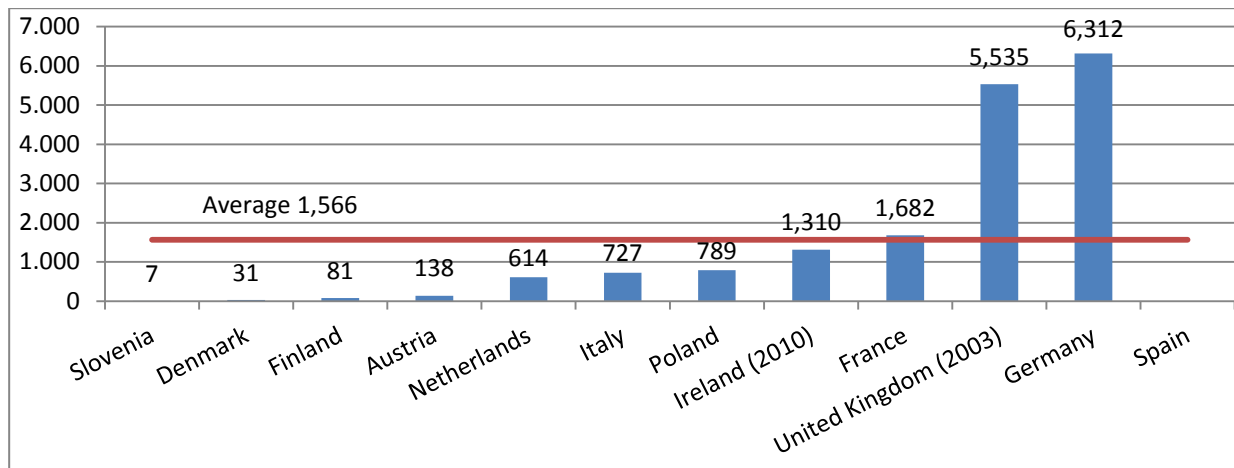
The following provides figures on the importance of commission based remuneration in insurance. This part overlaps with part 4.1 (pp 69 ff) where empirical evidence is provided on the role of different linked intermediaries in the marketing of insurance and other financial services. The reader will be mindful that while the present distinction into functions of marketing and persons involved serves the purpose of better identifying the elements which could lead or constitute a conflict of interest, an integrated view of both aspects provides a more complete picture of the market.

2.3.1 Life insurance

The Figure shows OECD data of the total commissions paid by insurance companies for the direct life insurance business in 2011, based on balance sheets and income statistics of insurance companies.

⁵³ Insurance Europe (2013a): European Insurance in Figures 2013. CEA Statistics No. 46, p. 24-26.

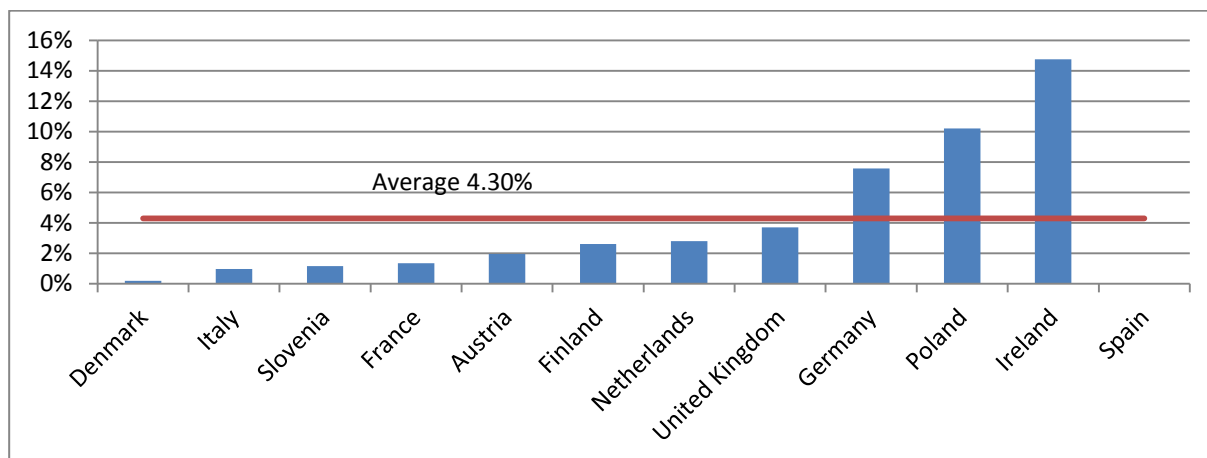
Figure 12: Total commissions in life insurance (direct business) 2011, in EUR million



Source: OECD (2013): Dataset: Commissions in the reporting country 2002-2011. OECD.Stat. Own composition

For the 12 selected member states (except Spain) the average volume of commissions is EUR 1.566 bn, which is EUR 754 million above the average for the whole of Europe. Germany ranks first, followed by the UK and France. With an amount of EUR 6.312 bn, the commissions in Germany are 3.75 times higher than in France. The amount of EUR 5.535 bn in the UK is the second highest in the total of Europe. However, it refers to the year 2003, because more recent data is not available. These differences in absolute numbers may be due to different market sizes. The order of countries changes if we relate the volume of commissions to the total gross premiums per year. As shown in Figure 5, this ratio is highest in Ireland (14.74%), followed by Poland (10.21%) and Germany (7.59%), where it is still nearly twice as high as the average. In Europe as a whole, however, Luxemburg is at the top, where nearly 40% of the premiums are paid as commissions to intermediaries.

Figure 13: Total commissions in life insurance (direct business) to insurance premiums 2011, in per cent



Notes: Finland: without statutory pension insurance. Netherlands: including indirect insurance business.

Source: OECD (2013): Dataset: Commissions in the reporting country 2002-2011. OECD.Stat.; Insurance Europe (2013b): The European Life Insurance Market in 2011. CEA Statistics No. 47. Own calculations.

The low ratios in Denmark and Finland reflect the ban on commissions for brokers introduced respectively in 2006 (Denmark⁵⁴) and 2008 (Finland⁵⁵) and refer to commission earnings of insurance agents that are not covered by the prohibition. The other differences may be due to differences in distribution channels and market structures or competition. If brokers receive higher commission rates than other sales agents (see Germany), countries with a comparatively high share of brokers (Ireland, UK, see Figure 28 on page 83) tend to have higher commissions. Commission payments should also rise with the level of competition, usually indicated by a low concentration of the insurance market. As shown in the Figure, Germany is the member state with the lowest market share of the largest five life insurance groups (49.6%), followed by France (53.6%) and the UK (53.7%) with almost equal shares. A high level of competition in these markets may thus explain their comparatively high commission levels in Figure 12 and Figure 13. Ireland has the second highest concentration ratio (86.1%), but the highest ratio of commissions to insurance premiums, which does not seem to fit into this picture. However, competition may be even more intense in a tight oligopoly than in a wider one. The Irish life insurance market is dominated by three large players that compete aggressively for market shares by paying higher commissions in order to fill their capacities in a period of declining demand.⁵⁶ Commission levels should also rise with the concentration of the intermediary market. However, Germany has the highest number of financial intermediaries per capita (0.61) in Europe, which is more than twice as high as in the UK (0.27) and the Netherlands (0.2).⁵⁷ According to our survey results, the number of intermediaries in the capital life insurance market is 251,089 in Germany and 8,042 in the Netherlands. International statistics about the concentration of insurance intermediary markets are lacking.

In the **German life insurance market**, initial sales commissions amount to 2.5-4% of the insurance sum. Additionally, intermediaries are paid a commission over the lifetime of the contract (portfolio commission, *Bestandspflegeprovision*), which ranges between 1 and 2% p.a. of the annual premium.⁵⁸

On the basis of an online survey among insurance intermediaries in 2011, Beenken finds that the rate of commissions varies according to the type of intermediary and is higher for brokers than for tied intermediaries.⁵⁹ This indicates that insurance companies use commissions as financial sales incentives mainly for untied intermediaries. Based on the results of this survey, we calculated the total volume of sales commissions and portfolio commissions for life and health insurance.

54 Finanstilsynet: Response from the Danish FSA regarding the consultation on the Review of the Insurance Mediation Directive (IMD), Danish Financial Supervisory Authority, 2 March 2011.

55 Vakuutusvalvonta: Conditions required by general good for EEA-insurance intermediaries. In: Act on Insurance Mediation (570/2005).

56 Central Bank of Ireland: Address by Mark Burke, Head of Life Insurance Supervision to 'A future for the Life Pensions Industry' conference, Dublin, 31 January 2013.

57 Evers&Jung: Anforderungen an Finanzvermittler – mehr Qualität, bessere Entscheidungen, Studie im Auftrag des Bundesministeriums für Ernährung, Landwirtschaft und Verbraucherschutz, Hamburg, 2008, p.9.

58 <http://www.geld-banken-versicherungen.de/versicherungen/abschlussprovisionen-versicherungen.htm> (viewed 18/05.13); Beenken, M. (2011), Provisionen und Courtagen -was die Versicherer ihren Vermittlern zahlen, Ahrensburg: VersicherungsJournal-Verl. (Versicherungs-Journal Marktübersicht).

59 Beenken, M. (2011), Provisionen und Courtagen -was die Versicherer ihren Vermittlern zahlen, Ahrensburg: VersicherungsJournal-Verl. (Versicherungs-Journal Marktübersicht).

Table 6 shows that the average sales commission rate in German life insurance ranges from 1.9% for sub-agents to 3.9% for brokers. To calculate the mean commission rate, we weight the commission rates of the different intermediaries with their respective shares in the basic population, which differ significantly from the shares in the sample.⁶⁰ The results for sales commission rates are presented in Table 7. Since information on the shares of the sub categories (sub-agents, sub-brokers and sub-multi-tied-agents) are missing, we use two alternative weights:

Weight 1: Since only very few sub-intermediaries participated in the survey⁶¹ the mean commission rates are calculated by multiplying only the commission rates of the main intermediaries with their shares in the basic population (marked grey). In this case, the mean sales commission rate is 2.9 %.

Weight 2: We use the non-weighted means of the commission rates for the main and respective sub-intermediaries. By multiplying them with their weights in the basic population, we obtain a mean commission rate of 2.5% for the total market.

Table 6: Calculation of mean sales commission rate in German life insurance (2011)

INTERMEDIARY	SHARE OF BASIC POPULATION	SALES COMMISSION RATE	WEIGHT 1	WEIGHT 2
Exclusive Agents	75.80%	2.62%	1.99%	1.72%
Subagents		1.93%		
Brokers	17.20%	3.93%	0.68%	0.58%
Sub Brokers		2.83%		
Multi tied Agents	7.00%	3.46%	0.24%	0.20%
Sub Multi tied agents		2.21%		
Sum	100.00%		2.90%	2.50%
			Weight 1	Weight 2
Mean sales commission rate (in %)			2.90%	2.50%

Own calculations based on: Beenken, M. (2011), Provisionen und Courtagen -was die Versicherer ihren Vermittlern zahlen, Ahrensburg: VersicherungsJournal-Verl. (Versicherungs-Journal Marktübersicht).

Table 7 shows the calculations of the total sales commissions based on the new business sum insured⁶² in Germany for both weights. The development over time is illustrated in Figure 14. We find that total sales commissions reached 7-8 bn. Euro in 2011

Table 7: Calculation of total sales commissions in German life insurance 2006-2011

YEAR	NEW BUSINESS: SUM INSURED (IN EUR BN)	SALES COMMISSIONS* WEIGHT 1 (IN EUR BN)	SALES COMMISSIONS* WEIGHT 1 (IN EUR BN)
2006	251.4	7.301	6.296
2007	243.1	7.060	6.088

60 Beenken, M. (2011), Provisionen und Courtagen -was die Versicherer ihren Vermittlern zahlen, Ahrensburg: VersicherungsJournal-Verl. (Versicherungs-Journal Marktübersicht), p.8.

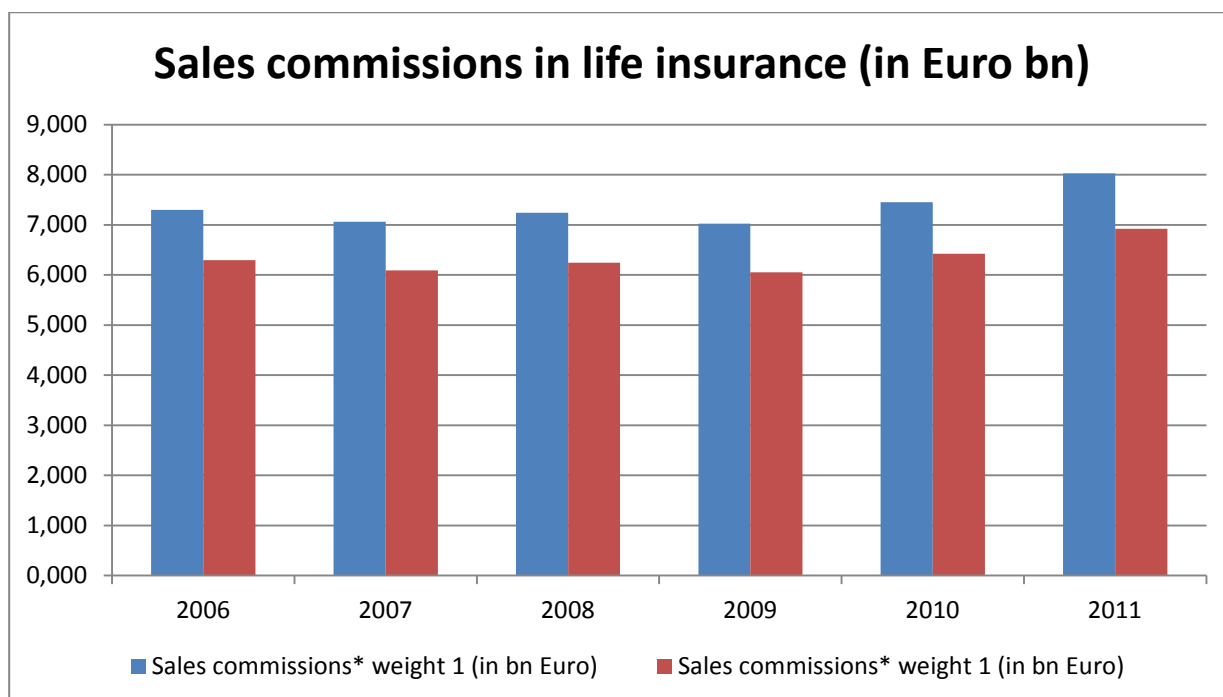
61 Beenken, M. (2011), Provisionen und Courtagen -was die Versicherer ihren Vermittlern zahlen, Ahrensburg: VersicherungsJournal-Verl. (Versicherungs-Journal Marktübersicht), p.9.

62 Gesamtverband der Deutschen Versicherer (2012), Statistical Yearbook of German Insurance 2012, Table 27.

YEAR	NEW BUSINESS: SUM INSURED (IN EUR BN)	SALES COMMISSIONS* WEIGHT 1 (IN EUR BN)	SALES COMMISSIONS* WEIGHT 1 (IN EUR BN)
2008	249.3	7.240	6.243
2009	241.8	7.022	6.055
2010	256.6	7.452	6.426
2011	276.3	8.024	6.919

Source: own calculations based on Gesamtverband der Deutschen Versicherer (2012), Statistical Yearbook of German Insurance 2012, Beenken, M. (2011), Provisionen und Courtagen -was die Versicherer ihren Vermittlern zahlen, Ahrensburg: VersicherungsJournal-Verl. (Versicherungs-Journal Marktübersicht). *assumption: commission rate of 2011 constant for all years.

Figure 14: Total sales commissions in German life insurance 2006-2011



Source: own calculations based on Gesamtverband der Deutschen Versicherer (2012), Statistical Yearbook of German Insurance 2012, Beenken, M. (2011), Provisionen und Courtagen -was die Versicherer ihren Vermittlern zahlen, Ahrensburg: VersicherungsJournal-Verl. (Versicherungs-Journal Marktübersicht). *assumption: commission rate of 2011 constant for all years

Table 8 shows analogous calculations for the portfolio commission rate.

Table 8: Calculation of mean portfolio commission rate in German life insurance (2011):

INTERMEDIARY	SHARE OF BASIC POPULATION	PORTFOLIO COMMISSION RATE (PER CENT)	WEIGHT 1	WEIGHT 2
Exclusive Agents	75.80%	0.60%	0.45%	0.27%
Subagents		0.10%		
Brokers	17.20%	1.30%	0.22%	0.17%
Sub Brokers		0.70%		
Multi tied Agents	7.00%	1.00%	0.07%	0.04%
Sub Multi tied agents		0.20%		
Sum	100.00%		0.75%	0.48%

INTERMEDIARY	SHARE OF BASIC POPULATION	PORTFOLIO COMMISSION RATE (PER CENT)	WEIGHT 1	WEIGHT 2
			Weight 1	Weight 2
mean portfolio commission rate (in %)			0.75%	0.48%

Own calculations based on: Beenken, M. (2011), Provisionen und Courtagen -was die Versicherer ihren Vermittlern zahlen, Ahrensburg: VersicherungsJournal-Verl. (Versicherungs-Journal Marktübersicht).

Portfolio commissions are based on the total premium income, which amounted to EUR 83.2 bn in 2011.⁶³ Multiplied by the commission rates 0.48 respectively 0.75, we find that the total volume of portfolio commissions in German life insurance reached 7.32 (weight 2) – EUR 8.65 bn (weight 1) in 2011.

Table 9: Total commissions in life insurance

EUR BN	WEIGHT 1			WEIGHT 2			
	Year	Sales commissions*	Portfolio commissions*	Total commissions*	Sales commissions*	Portfolio commissions*	Total commissions*
	2006	7.301	0.561	7.862	6.296	0.359	6.655
	2007	7.060	0.564	7.624	6.088	0.361	6.449
	2008	7.240	0.571	7.811	6.243	0.366	6.609
	2009	7.022	0.609	7.631	6.055	0.39	6.445
	2010	7.452	0.653	8.105	6.426	0.418	6.844
	2011	8.024	0.623	8.647	6.919	0.399	7.318

*assumptions: commission rate of 2011 constant for all years, no contract cancellations.

Summing up, total commissions in German life insurance markets increased since 2009 and reached a maximum of EUR 7.3-8.6 bn in 2011, 93-94% of which are sales commissions (see Table 9). This volume is much higher than the volume of EUR 6.3 bn according to the OECD statistics (see Figure 12: Total commissions in life insurance (direct business) 2011, in EUR million), which may be due to the fact that data about the market shares of sub-agents are missing and contract cancellations are not taken into account in the present calculations. Given an average cancellation liability period of 4.6 years for intermediaries in life insurance markets, it becomes clear that the commission volumes calculated here represent only the theoretical maximum.

In German life insurance markets, customers are usually not informed about the level of commissions that is hidden in the premium. A consumer that would like to be informed about the costs of advice or administrative costs would only find a hint in the general terms and conditions of insurance that these costs exist and will be calculated in the premium.⁶⁴ Presumably the information will be provided upon request or when the contract is concluded. However, then it is too late to compare the price of advice between different intermediaries.

In **Austria**, most of the insurers inform customers about the actual height of sales and administrative costs in their general or specific terms and conditions of insurance. Thus,

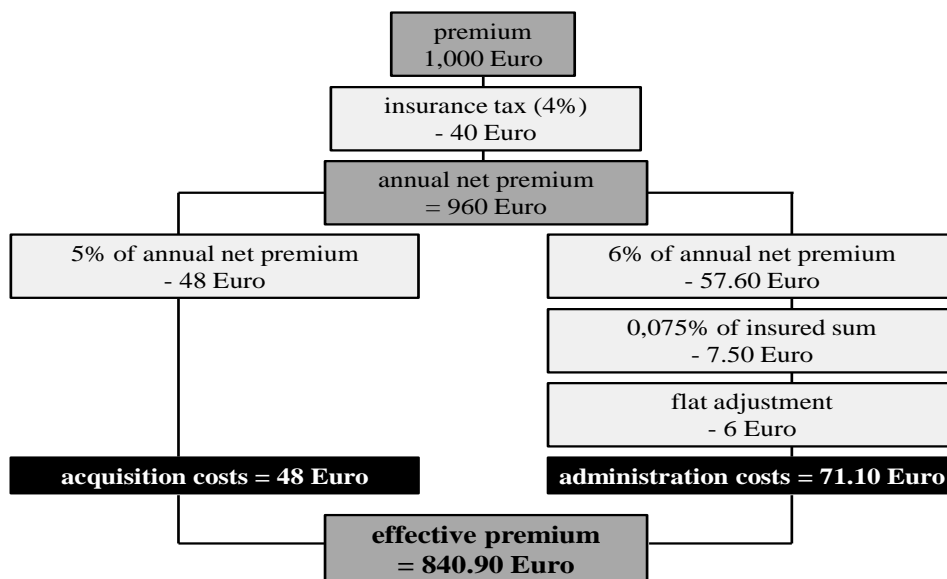
63 Gesamtverband der Deutschen Versicherer (2012), Statistical Yearbook of German Insurance 2012, Table 27.

64 Hannoversche (2012): Bedingungen und Informationen: Lebensversicherung, dated 01/2013. HUK-Coburg Lebensversicherung (2012): Versicherungsbedingungen HUK24.

customers may calculate which part of the insurance premium they pay for these costs. However, hints to these costs are often hidden and presented in an incomprehensible way, so that it can be assumed that the average consumer does not find or understand them. This problem for a German speaking audience is illustrated by the bureaucratic German language filled with a number of figures, rates and verbalised calculations to “explain” the closing fee that are used by some providers in their terms and conditions.⁶⁵

Assume that a consumer wants to buy a capital life insurance with an insurance sum of 10,000 Euro and a term of 10 years. To reach this sum at the end of the term he or she has to pay an annual premium of 1,000 Euro. On this premium, an insurance tax of 4% has to be paid.

Figure 15: Calculation of acquisition and administration costs



Source: Bank Austria Versicherung (2012): Besondere Versicherungsbedingungen (BVB) für Kapitalversicherungen (Tarif C) Deckung 81108/ Tarifvariante 12121, p.2. Own calculation and composition.

Figure 15 illustrates the calculation of acquisition and administration costs for this case. It shows that only 84.09% of the initially paid annual premium is effectively used for asset generation. Many customers do not pay yearly, but monthly premiums. In this case, an additional sum up to 5% of the premium is due as a short-term surcharge. Thus, the total cost burden is likely to reach 15%, which significantly reduces the guaranteed benefits of the life insurance.⁶⁶

Although the customer may thus calculate the costs of an insurance contract before its conclusion, he will not be informed about the height of commissions he pays with the premium. Providing information about acquisition cost without transparency about the

65 The following excerpt from the specific insurance conditions of a provider illustrates this: „Der für die Abschlusskosten zu tilgende Betrag gemäß § 5.1 (a) AVB ist bei Verträgen mit laufender Prämienzahlung auf 5,0% der Nettoprämien-summe und bei Verträgen gegen Einmalprämie auf 4,5% der Nettoeinmalprämie beschränkt. Die jährlichen Verwaltungskosten gemäß § 5.1. (b) AVB betragen bei Verträgen mit laufender Prämienzahlung 6% der Jahresnettoprämie zuzüglich 0,075% der Versicherungssumme zuzüglich EUR 6,-, bei Verträgen gegen Einmalprämie und prämienfrei gestellten Verträgen 0,15% der Versicherungssumme. Bei Verträgen mit laufender Prämienzahlung verringert sich die Gesamtprämie ab einer Prämienhöhe im Monatsausmaß von EUR 50,- um 1,0%, ab EUR 75,- um 1,5%, ab EUR 100,- um 2,5%, ab EUR 150,- um 3,5%, ab EUR 200,- um 4,0% und ab EUR 250,- um 4,5%“.

66 Verein für Konsumentenschutz (2012): Private Rentenversicherung. Arbeitskammer. Wien, p. 46.

insurance intermediary's remuneration does not suffice to make price comparisons between intermediaries possible and to ensure price competition on the market for advice.

2.3.1.1 Commissions in insurance distribution⁶⁷

In an effort to assist the research, a parallel but separate mystery shopping activity was carried out by the Austrian Chamber of Labour. It focussed on commission levels and disclosures. Mystery shoppers asked questions by email in reference to the costs of a contract including commissions or fees. The outcome is disappointing and shows that this question was rarely answered at great length, if at all.

In some cases, notes of costs and commissions were found in the documents sent.

A German insurance broker did address the questions regarding costs including commissions, right at the beginning by providing a sample broker's contract. However, despite this, the height of the commission was not stated. Two other insurance brokers provided tabular comparisons (stating providers, commission height, premium sum) but this was done without cost information.

The mystery shopper explicitly asked about the costs of advice enquiring specifically about acquisition cost and, in a second e-mail, if a commission was paid for by the provider. This was in the context of data concerning an offer being sent by the broker. The brokers' response made reference to those questions but did not mention the height of commission(s). Indeed, the following answer, given by a German broker, was typical: *"The broker's commission is always paid for by the insurer, bank and so on. Therefore no additional costs will be drawn on you"*. Worse, after stressing that advice would be completely free of charge, an Italian broker emailed an offer for which the attached documents made a reference to expenses.

Some responses were however more satisfactory. A Dutch broker (S) sent an answer stating that he worked on a fee basis. For term insurance he would be charging 340 Euro, for classic life insurance between 340 and 765 Euro, depending on effort (4 to 9 hours). Possible allowances granted by insurances were disclosed in the context of the actual (with costs) market overview/offer preparation as well. A German insurer (D) can be cited as an example of good practice. The insurer broke down acquisition as well as administration costs in the individually prepared product information sheet as follows:

"Acquisition as well as distribution costs amount to 2813.55 EUR total. They provide, among others, as payment for costs of development and provision of advice- and prevention-software, product development, advice effort, application review as well as the preparation of contract documents. We stand at your side during contract duration as well. For this you can reach our nationwide customer service personally or by phone at over 1200 places. All administration costs in relation to this service and your contract for your annuity insurance of yearly 139.15 EUR for the duration of 32 years in the lifetime of the insured person + yearly 47.61 EUR for the duration of the pension period of the insured person are not charged separately, but are already included in your premium."

In addition, reference to the damaging effect on revenues of these costs was made, and a total expense ratio of 0.55% was calculated.

⁶⁷ Results of a mystery shopping survey run between May and July 2013 with 167 intermediaries selling life insurance policies (with and without an investment component). The test characteristics for the email correspondence aimed at obtaining individualised non-binding offers were based on the following two consumer profiles: Mystery Shopper 1 (35 years of age, 15 year policy duration) and Mystery Shopper 2 (49 years of age, 15 year policy duration). The first shoppers (114) were contacts made with 5 largest insurers, banks and brokers in 11 Member States, whereas the second shoppers (53) contacted intermediaries looking through search engines aimed at replicating the process a consumer would face, this was done in the largest six Member States only (Poland, France, Italy, Spain, Germany, UK). More details about this survey are available from the authors at AK Wien.

More generally, German insurance companies are an example of good practice, as they state acquisition costs in mandatory **product information sheets**.

But clear information on costs is unfortunately an exception. The survey found some intriguing and confusing examples. To cite only one, an Italian broker explained: 'after all calculated 24% of premiums for acquisition and administration costs for insurance sums below EUR 150000, representing 33 Euro per year'. Curious still, the broker only offered one product by one provider and after a second inquiry could or did not want to offer any savings product.

Table 10: Overview on acquisition costs (commissions) in received offers/tenders for classic life insurance (from mystery shopping 1)

	LIFE-SPAN (YRS.)	MONTHLY PREMIUM	SAVED AMOUNT (GUARANTEED)	DISBURSEMENT DEATH (GUARANT.)	COMMISSION STATED?	HEIGHT? (EURO)	ACQUISITION COSTS IN % OF PREMIUM	ADMINISTRATION COSTS STATED?	HEIGHT? (EURO)
Insurance A (Germany - Insurance)	30	200 (173,72 + 26,28)	78.274	78.274 plus surplus sharing	offer	2.892,40	4,02%	yes, in offer	Yearly 106,09 additional. 0,40 je 100 EUR actuarial reserve
G Insurance (Germany - Insurance)	30-35	200	73901	73901	product information sheet	2.764,82	3,84%	yes, in product information sheet	259,64
D Insurance (Germany - Insurance)	32	monthly 200 (without surplus sharing 211,22 = 186,35 + 24,87 for additional accident)	80.495,07	80.495,07 plus 52.906 (supplementary accident)	product information sheet	2.813,55	3,70%	yes, in product information sheet	139,15 yearly
Insurance broker W (Germany - Broker)	30	200	78.492	78.492	Email	Not stated, due to dependency on product	No specific declaration	Yes, in E-mail	Not stated, due to dependency on product

Source: AK Wien mystery shopping exercise June 2013.

While the results of the survey have no statistically representative character, they are nevertheless indicative of the situation consumers are confronted with (when trying to get information on a distance selling basis). Response rates to the emails asking for offers was high. Of the 167 financial intermediaries contacted (covering 11 Member States), 62% responded to the first mystery shopping exercise and 51% responded to the second, with actual providers sending offers falling to 13% and 23% respectively (i.e. a total of 27 providers from both tests). The response rate differed from country to country with German intermediaries showing the highest responsiveness and those from Italy the lowest. While the email responses received were generally sent within 24 hours, however many gave excuses for why they could not send the requested offer by email, with most calling for the necessity of having a personal consultation in order to receive one (whether face-to-face or via telephone). As alluded to above, the country variation in information standards was large and the German providers (banks, insurer and broker) were the most

reliable in terms of providing comprehensive information and data (including on costs and commissions), mainly because most providers sent the product information sheet as an attachment to their email response. While these sheets provided details of closing commissions broken down in Euro amount, not all provided the cost calculation as a percentage of the premium.

The exercise was also able to provide the research with empirical examples of the level of commissions charged by intermediaries. The resulting spread of commissions in insurance intermediation in the 11 Member States expressed as a percentage of premium volume were the following: For mystery shop 1 (N=15), the spread of commissions of life insurance contract (with investment) was 3.7%-4.2%, and for pure risk life insurance 2.75%-3.85%. For mystery shopping 2 (N=12), the spreads ranged from 3.17%-3.98% and 3.7%-6.23% respectively.

In addition to collecting some anecdotal evidence of specific commission rates being offered to consumers, and providing insights on the sparse information provided by intermediaries on fees as outlined above, some further lessons from the parallel mystery shopping exercise on the consumer perspective can be drawn on areas such as the extent of weak transparency on commissions and fees and problem of comprehensibility of cost information that is currently being provided.

For example, transparency of remuneration in insurance intermediation is generally quite low. Questions in regard to remuneration were answered only partly and in a delayed manner. Even when such disclosures existed, they were often very vague and kept quite general (*'the insurer pays a commission'*) and several successive inquiries were necessary before obtaining this disclosure. Some written declarations were even misleading, such as: *'Our service is completely free of charge; we receive a commission by the company.'* or *'No fee is charged, the review of documents is done on goodwill.'* This promotes a free-of-charge culture, that is not conducive to the necessary change in mind-set of consumers with respect to this subject. The statements received and their formulation basically prevent cost-consciousness and hide the fact that the customer will actually eventually pay the service received through an invisible commission. Written information provided by brokers about themselves and their service barely contained useful information but rather shared the properties of advertising material. Only one German insurance broker stated that the insurance company pays him a commission for the intermediation of insurance policies, which while not being very precise, nevertheless has the positive feature that at least it was provided to the tester without prior solicitation to receive it.

Also disappointing were the results with respect to the clarity and usability of the cost information as obtained by the tester (consumer). In some cases it remained unclear how statements on costs were to be understood. Examples include: a Spanish life insurance undertaking that stated in their information under costs as *'1% on the premium'*. This may not be sufficiently understandable for an inexperienced consumer that may not be in a position to know the number the percentage should be calculated from among the various numerical values and cost categories; and many offers by Italian insurers where the costs (fees and commissions) cannot be properly attributed to the various exact parties in the chain of transaction (i.e. who receives the payment, insurer, intermediary, other entity). A further statement from a French broker serves as an example of the ambiguity of responses consumers are confronted with: *'2% by your adviser'* - does this mean that the intermediary will keep 2% of payment outflows from the policy holder as remuneration? Likewise, the statement from another French broker: *'Des frais d'entrée de 5% sont prélevés sur les sommes versées'* does not clarify who will ultimately receive these entry fees, highlighting the lack of an explicit reference to the party that is being remunerated.

2.3.2 Non-life insurance

In contrast to most life insurance products, in **Germany** non-life insurance products do not have contractually fixed insurance sums on which sales commissions could be based. Both sales commissions and portfolio commissions are therefore typically based on the monthly premiums paid. The initial commission rates in Germany vary by product class as shown:

Table 11: Sales commission rates in German non-life insurance

PRODUCT	AMOUNT OF SALES COMMISSION
Private health insurance:	5 to 8 monthly premium payments (occasionally even more than 12 months)
Work disability insurance:	approx. 70% of first annual premium
Car insurance:	8 to 11% of annual premium
Household insurance:	approx. 20% of annual premium
Accident insurance:	approx. 70% of first annual premium
Private liability insurance:	approx. 70% of first annual premium

Source: Website www.geld-banken-versicherungen.de.

In addition, all insurance agents receive a commission paid over the lifetime of the contract (portfolio commission, *Bestandspflegeprovision*). For health insurance this is between 1 to 2% p.a., for accident and household insurance approximately 10% of the annual premium.⁶⁸

According to Beenken (2011), the sales commissions in German health insurance amount to 4.3 – 7.6 monthly premiums. With an average monthly premium of about 300 Euro⁶⁹ the sales commission reaches 1.290 - 2.280 Euro, depending on the type of the intermediary. In addition, the sales agent receives a yearly portfolio commission, which is about the same percentage as in life insurance (1-2% p.a.).⁷⁰

The commission rates in the (private) health insurance market are calculated in the same way as above (see chapter 2.3; see Table 12 for sales commissions).

Table 12: Calculation of mean sales commission rate in German health insurance (2011)

INTERMEDIARY	SHARE OF BASIC POPULATION	SALES COMMISSION RATE (per month)	WEIGHT 1	WEIGHT 2
Exclusive Agents	75.80%	5.00	3.79	3.5247
Subagents		4.30		
Brokers	17.20%	7.60	1.3072	1.1782
Sub Brokers		6.10		
Multi tied Agents	7.00%	6.90	0.483	0.3955
Sub Multi tied agents		4.40		
Sum	100.00%		5,5802	5.0984

68 <http://www.geld-banken-versicherungen.de/versicherungen/abschlussprovisionen-versicherungen.htm> (viewed 18/05.13)

69 See GDV (2012): Statistical Yearbook of German Insurance 2012. Gesamtverband der Deutschen Versicherungswirtschaft e.V. Berlin, Table 45, own calculation.

70 Beenken, M. (2011), Provisionen und Courtagen -was die Versicherer ihren Vermittlern zahlen, Ahrensburg: VersicherungsJournal-Verl. (Versicherungs-Journal Marktübersicht), p. 28.

	WEIGHT 1	WEIGHT 2
Mean sales commission rate (per month)	5.58	5.0984
Mean sales commission rate per year (in % of yearly premium (2011))	46.50%	42.49%

Note: Own calculations based on: Beenken, M. (2011), Provisionen und Courtagen -was die Versicherer ihren Vermittlern zahlen, Ahrensburg: VersicherungsJournal-Verl. (Versicherungs-Journal Marktübersicht).

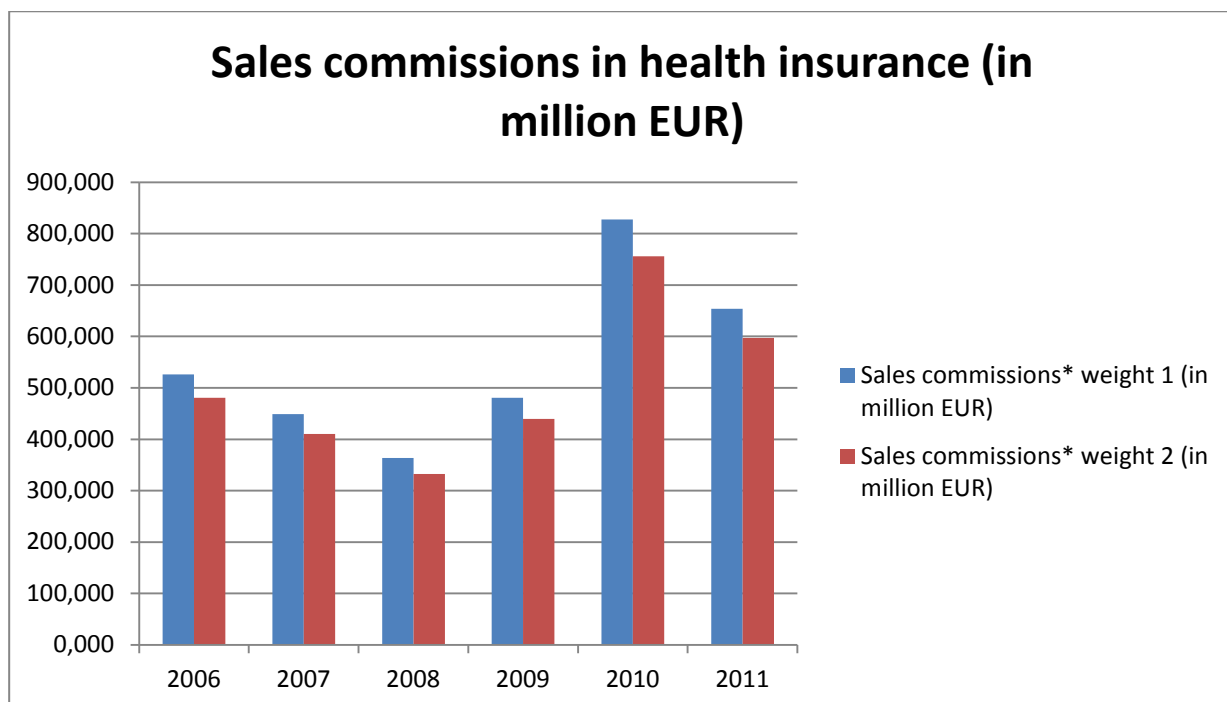
Since data on the total premium income from new business is not available, we calculated the mean sales commission rate on the basis of the difference in the premium income (p.a.) with respect to the previous year. Since this difference results from both, new business and contract cancellations, our calculations understate the actual height of commissions paid (see Table 13 and Figure 8).

Table 13: Calculation of total sales commissions in German health insurance 2006-2011

YEAR	TOTAL PREMIUM INCOME** (in million EUR)	TOTAL PREMIUM INCOME FROM NEW BUSINESS (Difference to previous year) (in million EUR)	SALES COMMISSIONS* weight 1 (in million EUR)	SALES COMMISSIONS* weight 2 (in million EUR)
2006	26.612	1.132	526.399	480.949
2007	27.578	966	449.206	410.421
2008	28.360	782	363.643	332.246
2009	29.394	1.034	480.827	439.312
2010	31.174	1.780	827.730	756.263
2011	32.580	1.406	653.813	597.363

Source: own calculations based on Gesamtverband der Deutschen Versicherer (2012), Statistical Yearbook of German Insurance 2012, Beenken, M. (2011), Provisionen und Courtagen -was die Versicherer ihren Vermittlern zahlen, Ahrensburg: VersicherungsJournal-Verl. (Versicherungs-Journal Marktübersicht)." *assumptions: commission rate of 2011 constant for all years, no contract cancellations. ** health insurance without compulsory long-term care insurance.

Figure 16: Total sales commissions in German health insurance 2006-2011



Source: own calculations based on Gesamtverband der Deutschen Versicherer (2012), Statistical Yearbook of German Insurance 2012, Beenken, M. (2011), Provisionen und Courtagen -was die Versicherer ihren Vermittlern zahlen, Ahrensburg: VersicherungsJournal-Verl. (Versicherungs-Journal Marktübersicht). *assumption: commission rate of 2011 constant for all years.

Analogous calculations for portfolio commissions in health insurance show that these reached 147 (weight 2) - 258 (weight 1) EUR million in 2011 (see Table 14). Thus, the total commissions in the German health insurance markets amounted to EUR 745-912 mln in 2011, 72-80% of which are sales commissions.

Table 14: Calculation of total portfolio commissions in German health insurance 2006-2011

YEAR	TOTAL PREMIUM INCOME** (in million EUR)	PORTFOLIO COMMISSIONS* weight 1 (in million Euro)	PORTFOLIO COMMISSIONS* weight 2 (in million Euro)
2006	26.612	211.033	120.180
2007	27.578	218.694	124.542
2008	28.360	224.895	128.074
2009	29.394	233.094	132.743
2010	31.174	247.210	140.782
2011	32.580	258.359	147.131

Source: own calculations based on Gesamtverband der Deutschen Versicherer (2012), "Statistical Yearbook of German Insurance 2012", Beenken (2011), "Provisionen und Courtagen -was die Versicherer ihren Vermittlern zahlen". *assumptions: commission rate of 2011 constant for all years, no contract cancellations. ** health insurance without compulsory long-term care insurance.

2.3.3 Contingent commissions

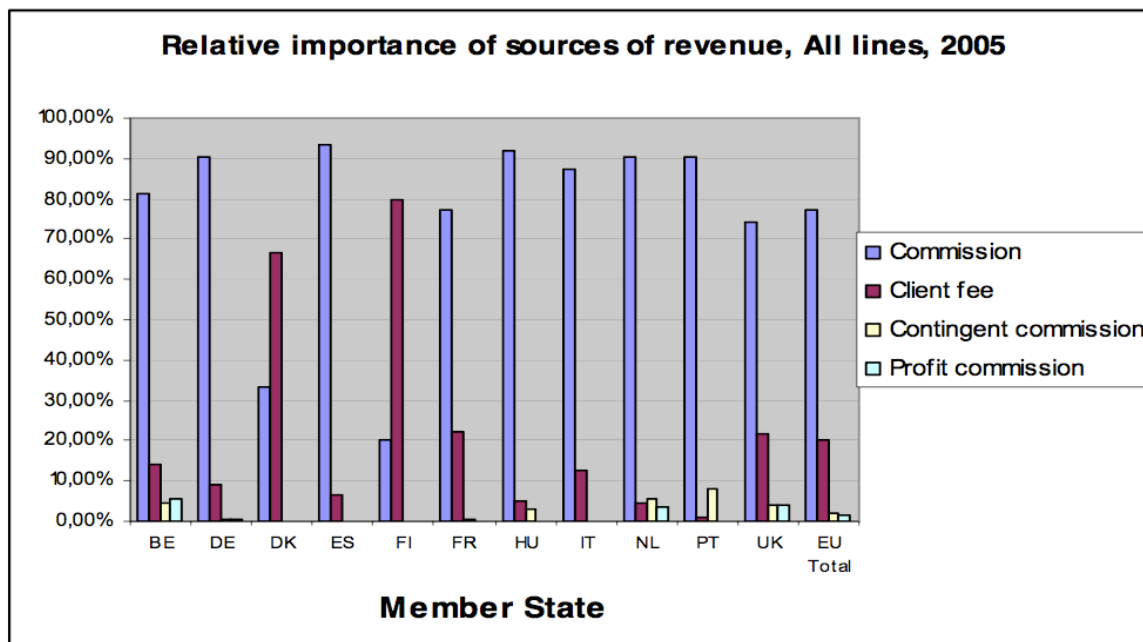
Volume-based sales commissions remain the most widespread form of remuneration for advice in investment⁷¹, credit⁷² and insurance markets, except in the countries that introduced a ban on commissions. The following figure depicts the composition of insurance intermediaries' revenue for all non-life business lines as of 2005.⁷³

71 Deutsche Bank Research, Fee vs commission. Quality of advice is not only determined by remuneration, March 27, 2012, p.8.

72 Europe Economics, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H) Contract ETD/2007/IM/H3/118 Final Report 15 January 2009

73 EC (2007): Business insurance sector inquiry

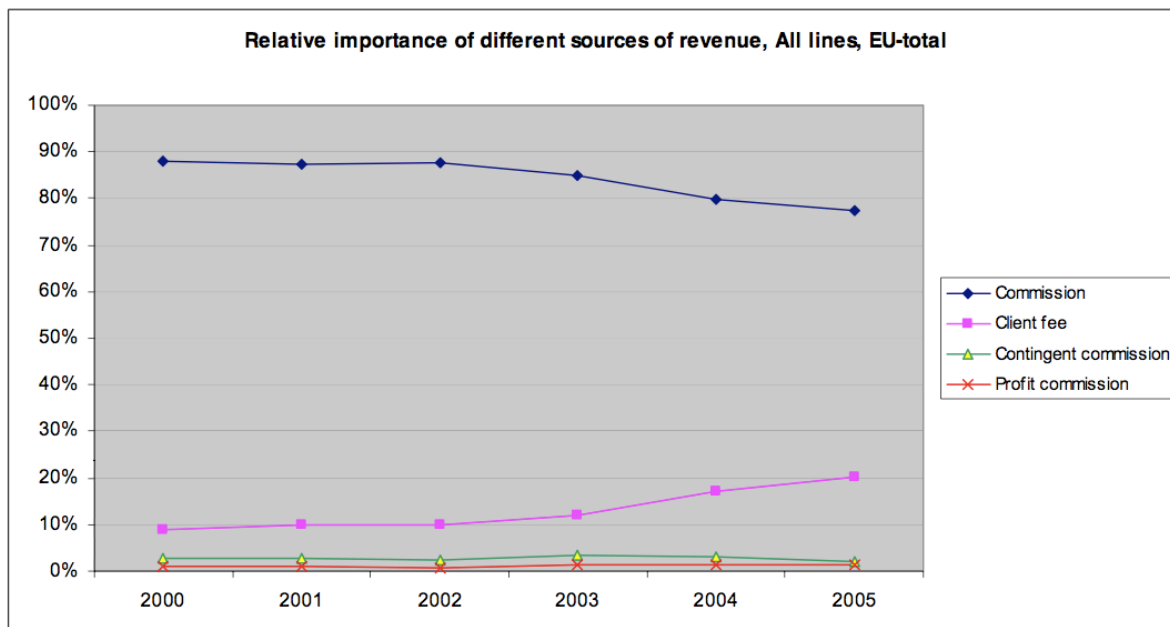
Figure 17: Relative importance of sources of revenue



Source: EC (2007): Business insurance sector inquiry, p. 117

According to this survey, commissions are the major source of revenues of intermediaries. Only in Denmark and Finland are client fees more important. From 2000 to 2005, the relative importance of commissions on the EU-Total level has decreased slightly but remains the major source of revenues, as this figure illustrates.

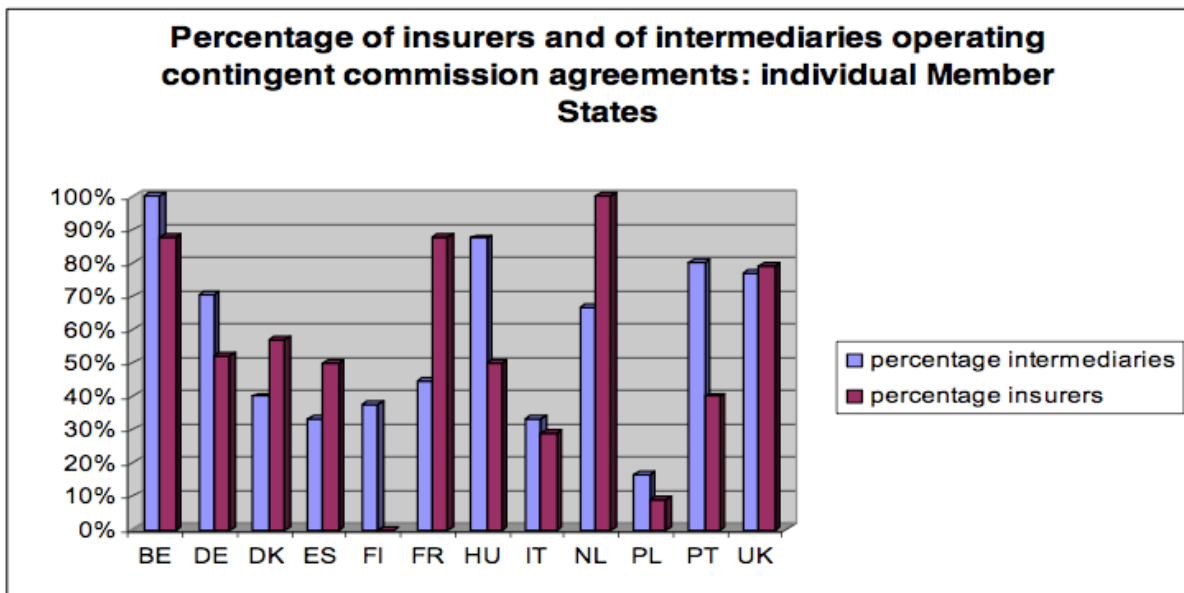
Figure 18: Relative importance of different sources of revenue



Source: EC (2007): Business insurance sector inquiry, p. 118

In terms of contingent commissions, Figure 19 shows the estimated percentage of respondents which operated contingent commission agreements at any point in time during the period 2003-2006.

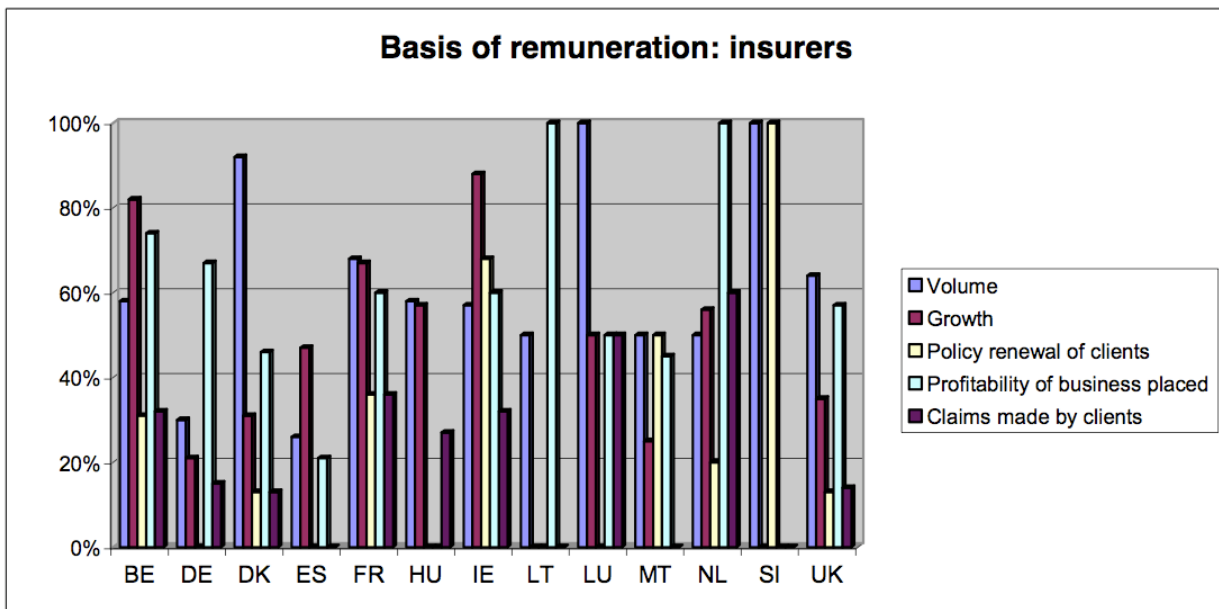
Figure 19: Percentage of insurers and intermediaries operating contingent commission agreements



Source: EC (2007): Business insurance sector inquiry, p. 126

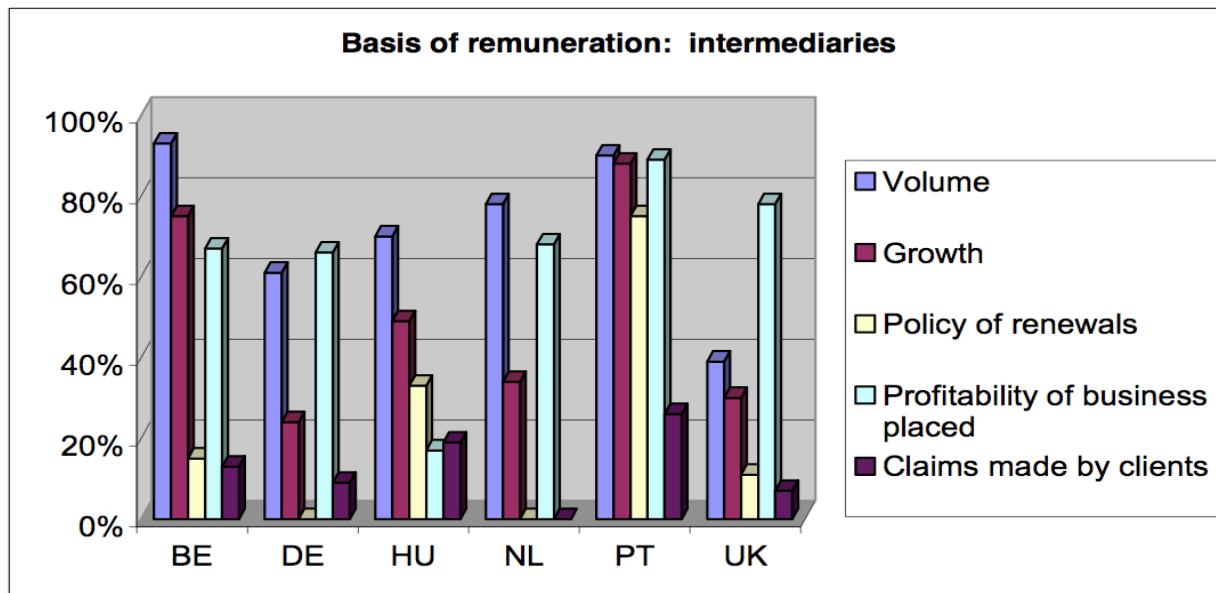
In addition, two figures show the criteria used for in contingent commission arrangements by both insurers and intermediaries, including volume, growth, policy renewal, profitability and claims.

Figure 20: Basis of remuneration: insurers



Source: EC (2007): Business insurance sector inquiry, p. 127

Figure 21: Basis of remuneration: intermediaries



Source: EC (2007): Business insurance sector inquiry, p. 128

A comparison with the credit and investment markets shows that also there contingent commissions prevail and are predominantly paid directly to the intermediary by the supplier.

According to the 2007 survey of Europe Economics, only 2% of the intermediaries in residential mortgage markets receive fees from customers, while 59% are remunerated only by the provider. Just fewer than two fifth received remuneration from both parties. Volume-based commissions play a significantly larger role for tied intermediaries, while fixed commissions play a larger role for untied ones.⁷⁴

In 2012, “Which?” conducted a study to investigate if there had been a change in banking culture. They spoke to over 500 frontline staff of Britain’s five big banks. The key findings were that business reality still contradicted public statements pledging reforms in bonus schemes and business politics, and that sales pressure was still pervasive for sales staff.

Although pecuniary incentives seem to have diminished, there still is a strong sales culture. Instead of rewarding sales, selling is “entrenched in the job” and expected of staff (“you accept it or you leave”). Sales targets are still predominant and promoted through pressure from managers. This is for example supported by day-to-day emphasis to sell, the publication of the numbers of individual sales made within the team and the use of computer systems prompting staff to sell to customers. General performance reviews still focus on sales reviews. In addition, in some cases, promotions might be linked to sales accomplishments or one could lose their bonus when not meeting their sales target. So instead of rewards or supplements (carrots), negative incentives and high pressure seem to be at hand (sticks).

In all five banks surveyed, over a third of employees say that they feel like they are underachieving if they don’t make enough sales. Although many employees state that they are told to do only needs-based selling, this hardly seems to be enforced and also stands

74 Europe Economics, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H) Contract ETD/2007/IM/H3/118 Final Report 15 January 2009, p.108.

in opposition to high sales targets. A high number of employees say they know colleagues who have mis-sold to meet sales targets.

In comparison, Lloyds' sellers seem to be under significantly more pressure to sell, whereas 61% of Barclays' sellers say they are comfortable with the level of pressure. However mis-selling and a high sales pressure still seem to be prevalent. At HSBC's, two thirds of sellers with targets still receive financial incentives. This banks still has a significantly high number saying they're unlikely to be promoted if they don't make enough sales.

So despite an orientation towards customer service targets, as stated by a Santander team manager, for example, it is obvious that sales are still the priority. The study has highlighted that the culture of an organization, along with incentives and targets, is also a critical cause for low business standards. The problems observed in the study can hardly be considered as being country specific and have to be addressed on a global basis.

2.3.4 Fee-based remuneration

Although fee-based remuneration in comparison to commission-based remuneration systems are still of minor importance in Europe, fee-based remuneration schemes are gaining market-wide recognition and attention due to discussion regarding transparency rules and regulations in connection with consumer protection. Within that context, the U.K, Finland, Denmark and the Netherlands have already imposed a complete ban on commissions to independent insurance intermediaries.⁷⁵

In fee-based remuneration schemes, the services provided by the insurance intermediary – as well as the pricing – are directly negotiated (*ex-ante*) between the involved parties – the intermediary and the end-client. To accomplish this service scheme, the traditional advisory 'package' is decomposed into consulting services (covering the advisory part of the services provided) and transaction services (covering services and cost incurred with the execution) by also assigning a price for each component. For the pricing of the consulting services, a natural basis of calculation would be the duration of the consultation, the volume / notional amount of the financial transaction involved or the realised performance for the end-client.⁷⁶

Table 15 summarises the exemplary costs of fee-based advisory services in Germany for different distribution channels. A typical financial advice of 1.5 to 2 hours duration will cost between 400 and 500 euro. Additional fees come due for advice services by email or by mail.⁷⁷ Nevertheless, the major advantage of fee-based advisory services is obvious: compared to volume- or performance-based remunerations models, the incentives for 'churning' are smaller, except for unnecessarily long consultations. Additionally, the remuneration scheme is transparent and can easily be compared across different providers on top of just being in line with the user pays principle. A time based remuneration scheme generates for price sensitive customers, to require advisors to provide their services in a short time, not allowing them to go into detailed research for their clients. In this case, advisory quality and, ultimately, the end result are negatively impacted.⁷⁸

75 Berater (2012): Die Honorarberater kommen! In: Berater 12.2012, p.56.

76 Homölle, Susanne; Neumann, Wenke; Sydow, Sebastian (2013): Ist die Honorarberatung die bessere Beratung? In: Die Bank (01/2013), 38-43, p.40.

77 Finanztest (2009a): Am besten unabhängig. In: Finanztest 10/2009, 2009, 37–39, p.39.

78 Homölle, Susanne; Neumann, Wenke; Sydow, Sebastian (2013): Ist die Honorarberatung die bessere Beratung? In: Die Bank (01/2013), 38-43, p.40.

Table 15: Costs for Fee-Based Advisory

PROVIDER	PERSONAL CONSULTATION PER HOUR (EURO)	TIPS VIA EMAIL OR LETTER (EURO)	TIPS VIA TELEPHONE PER 15 MINUTES (EURO)
Feed-based advisory at consumer advice centre			
VZ Bayern	90	29	26
VZ Hessen	80	-	26
VZ Nordrhein-Westfalen	100	19-26	28
Feed-based advisory by publicly authorized experts			
Average	210	53	53
Feed-based advisory organisations			
Verbund Deutscher Honorarberater VDH GmbH	100-150	25	25
Deutsche Gesellschaft für Finanzplanung	125-150	25-31	25-31
Analytica Finanz Research Beratungs GmbH	238	n.a.	60
Self-employed fee-based advisors			
Average	182	n.a.	53

Source: Finanztest (2009a): Am besten unabhängig. In: *Finanztest* 10/2009, 2009, 37–39, p. 39, own calculations.

In the U.S., the majority of financial advisors are charging a certain percentage of the underlying investment volume.⁷⁹ Although this approach can – and actually is – supported by various measures to enhance the level of transparency, it is in most cases unclear what the exact link to the actual consulting component is.⁸⁰ Therefore, volume-based remuneration systems are very similar to commission-based schemes. The major advantage of the former is its apparently higher level of transparency.

Another alternative to price the advice provided to the consumer is by the aid of a performance model: the final price paid is a function of the performance achieved on the invested amount. The major advantage of these remuneration models is the *general* alignment of interests of the end-customer and the advisor. Nevertheless, differences in risk preferences might lead to misallocations and negative impacts for the customer as well as the advisor.

Dean and Finke (2011), in their study, evaluated 7,043 financial advisors in the U.S. and analysed the impact of different remuneration models on the amount of assets under management. The authors found that advisors using a fee-based remuneration system (using a time model as basis for the fee calculations), have customers with a comparably low level of wealth. The wealthier the clients, the higher the probability that a volume- or performance-based remuneration model is being applied.⁸¹

79 Dean, Luke R.; Finke, Michael S. (2011): COMPENSATION AND CLIENT WEALTH AMONG U.S. INVESTMENT ADVISORS. William Paterson University, Wayne, NJ. Dept of Economics and Finance.

80 Homölle, Susanne; Neumann, Wenke; Sydow, Sebastian (2013): Ist die Honorarberatung die bessere Beratung? In: *Die Bank* (01/2013), 38-43, p.41.

81 Dean, Luke R.; Finke, Michael S. (2011): COMPENSATION AND CLIENT WEALTH AMONG U.S. INVESTMENT ADVISORS. William Paterson University, Wayne, NJ. Dept of Economics and Finance.

2.4 Advantages and disadvantages of remuneration systems

In the following we present three different perspectives with regard to the question how far the existing remuneration systems create a conflict of interest for the different professions involved. We start with the stakeholder perspective which mirrors the political discussion about remuneration systems before we come to a more scientific evaluation from a sociological and an economic perspective.

2.4.1 Stakeholder perspective

When asked about the impact that sales commission-based remuneration could have on the performance of the insurance markets in terms of **service quality**, we received a mixture of answers ranging from very positive to negative. 32% of respondents consider that there will be a positive impact on the performance of insurance markets if sales commission-based remuneration is introduced (e.g. AT, IE, IT, PL and SL). Another 36% consider the impact as negative (e.g. DE, FI, FR, IE, IT, NL). The rest of the respondents are less aware of that problem (e.g. FR – Trade associations, PL - Authority and IT- Trade unions).⁸²

When asked about the future impact of sales commission-based remuneration on the performance of the insurance markets in terms of **accuracy of information**, 19% have given a positive answer (e.g. AT, DE, IE, PL). 28% thought that the impact in terms of accuracy of information will be negative (e.g. FR, IE, IT, SI). Over half of the responding organisations represented in Denmark, France, Ireland, Italy and Poland are not aware or do not know whether the accuracy of information in the insurance markets will be positively or negatively influenced by commission-based remuneration. It seems that there is a lack of knowledge in the insurance market about how it will react to commission-based remuneration for sales.⁸³

46% of all respondents assumed that impact of sales commission-based remuneration on the performance of the insurance markets in terms of **sales volume**, (n=22) will be positive (e.g. AT, DE, FR, IE, IT, NL, PL). Another 22% considered the impact as negative (e.g. DK, FI, NL, PL, SI). In contrast to the previous question on the accuracy of the remuneration, we see more awareness of how the insurance market will react to certain changes. The rest 32% were not aware or do not know whether the impact on sales volume in the insurance market will either positive or negative (e.g. DK, FR, IT, PL).⁸⁴

When asked about the negative impact of sales commission-based remuneration on the performance of the insurance markets in terms of **insurance premium**, a quarter answered positively (e.g. AT, IE, PL). In this case, 44% negative and neutral answers were indicated by respondents from Germany, Denmark, Finland, France, Ireland Italy, Netherlands and Poland. 33% of the respondents are not aware of what the impact will be (e.g. other respondents from DK, FR, IT, PL, NL).⁸⁵

2.4.2 Sociological perspective

The next two sections compare the commission and the fee-based remuneration systems seen from the interest of the intermediary as well as the customer.

82 See Annex Table Q145.

83 See Annex Table Q146.

84 See Annex Table Q147.

85 See Annex Table Q148.

Advantages and disadvantages for financial intermediaries

The major advantage of fee-based remuneration is that the intermediary's remuneration is independent of the successful sale of a corresponding product. Therefore, sales pressure is reduced and his reward is solely dependent on the consulting component. A potential side-effect of this confidence leveraging mechanism might be reduced costs for the acquisition of new customers. The customer – being aware of the fact that the advisory service is priced and not for free – will, by self-selection, help alleviate the adverse customer selection inherent in commission based remuneration systems. This is because in the latter the advisory service is apparently cost-free resulting in cross-subsidisations and, ultimately, in adverse customer selection.⁸⁶ Commission based remuneration schemes often include an indemnity period for premature cancellations of contracts for up to five years. Therefore, a premature cancellation of contract by the customer poses a threat to income for the intermediary. As a consequence, this kind of fee-based system provides some sort of reduced uncertainty regarding the level of income of the intermediary.⁸⁷ Nevertheless, this assumes that the customer is able to prospectively evaluate the benefits and quality of the advisory services, and correspondingly attach a fair price to it, which they are willing to eventually pay. Evidence shows that this is a daunting task in practice.⁸⁸ Therefore, for the acquisition of new customers, commission based remuneration systems prove to be more attractive because a customer is less resistant to advice if they do not bear the costs of consulting services that may eventually turn out to be useless. In addition, the intermediary has the opportunity to generate revenues for the advisory components without the customer explicitly paying for it.⁸⁹

Advantages and disadvantages for customers

Factoring out conflicts of interest, the benefit for the customer of a particular remuneration system is primarily driven by the notional amount of the underlying transaction: if an insurance product is bought with an amount insured of EUR 5,000, a commission at 5% would result in revenues of EUR 250 under a commission-based scheme. If a fee-based system was applied, the overall costs would quickly exceed the EUR 250 (duration of consultation longer than approx. two hours). If instead, the customer is buying insurance for EUR 50,000 it is obvious that the fee-based system is more favourable. Therefore, in general, fee-based remuneration systems become more attractive with increasing amounts invested.⁹⁰

One advantage of commission-based systems is the apparent cost-free advisory services from a customer's point of view. For the financially educated customer, this is a disadvantage because they would – based on their experience and knowledge – not buy or use advisory services in the first place, but have to indirectly pay for it.⁹¹

86 Homölle, Susanne; Neumann, Wenke; Sydow, Sebastian (2013): Ist die Honorarberatung die bessere Beratung? In: Die Bank (01/2013), 38–43, p.41.

87 Evers, Jan; Habschick, Marco (2008): Anforderungen an Finanzvermittler - mehr Qualität, bessere Entscheidungen. Studie im Auftrag des Bundesministeriums für Ernährung, Landwirtschaft und Verbraucherschutz. Hamburg, p.86.

88 Einfeldt, Knut (2013): Alles nur eine Frage der Vergütung? In: Der Honorarberater Ausg. 25, 02-2013, p.19.

89 Homölle, Susanne; Neumann, Wenke; Sydow, Sebastian (2013): Ist die Honorarberatung die bessere Beratung? In: Die Bank (01/2013), 38–43, p.38.

90 Dean, Luke R.; Finke, Michael S. (2011): COMPENSATION AND CLIENT WEALTH AMONG U.S. INVESTMENT ADVISORS. William Paterson University, Wayne, NJ. Dept of Economics and Finance.

91 Homölle, Susanne; Neumann, Wenke; Sydow, Sebastian (2013): Ist die Honorarberatung die bessere Beratung? In: Die Bank (01/2013), 38–43, p.39.

One aspect of feed-based remuneration systems to look upon favourably is the high degree of adherence to the 'user pay' principle. By splitting out advice from transactions services, the customer is able to easily and quickly compare different offers. Additionally, it allows customers to minimize the transaction costs piece of the overall cost structure.⁹²

A major problem, and one reason for the sparse prevalence of fee-based systems, is the lack of acceptance of this kind of remuneration model. In 2011, the market share of fee-based remuneration systems in Germany was 1%.⁹³ According to Franke et al. (2011) the reason is that customers can either not afford advisory services based on fees or are not willing to pay for them. Therefore, one of the dangers of introducing fee-based systems is that customers with low levels of income and/or wealth will not use the advisory services at all resulting in undersupply.⁹⁴

Even if a fee-based system was deemed superior, it is not enough to change the remuneration system as such. For example the corresponding German draft law introducing better conditions for fee-based systems goes far beyond the requirements of "fee-based advice". It understands this notion as "independent advice" with regard to the supplier interest when it regulates: „An investment firm is only allowed to provide fee-based investment advice if it provides such advice exclusively or separates such advice (...) from other investment advice. Guidelines for the marketing of investment products should be designed in a way that under no circumstances conflicts of interests with clients may occur.“⁹⁵ Other possible dependencies have to be disclosed (Article 31 (4c)). Additional requirements for the admission to this specifically regulated profession also concern the independence of the advisor towards the supplier.⁹⁶

There is certainly a temptation to assume that fee based systems would solve the conflicts of interest and only investigate why such systems have achieved so little importance in retail financial services if, from a consumer point of view, such systems would be much more advantageous than commission-based systems.⁹⁷

92 Homölle, Susanne; Neumann, Wenke; Sydow, Sebastian (2013): Ist die Honorarberatung die bessere Beratung? In: Die Bank (01/2013), 38–43, p.41.

93 Ludwig Finanzberatung auf Gegenseitigkeit (2011): Neues Bezahlsystem in der Honorarberatung - ein Hoffnungsschimmer für die verschmäht Branche?, www.presse-portal.de.

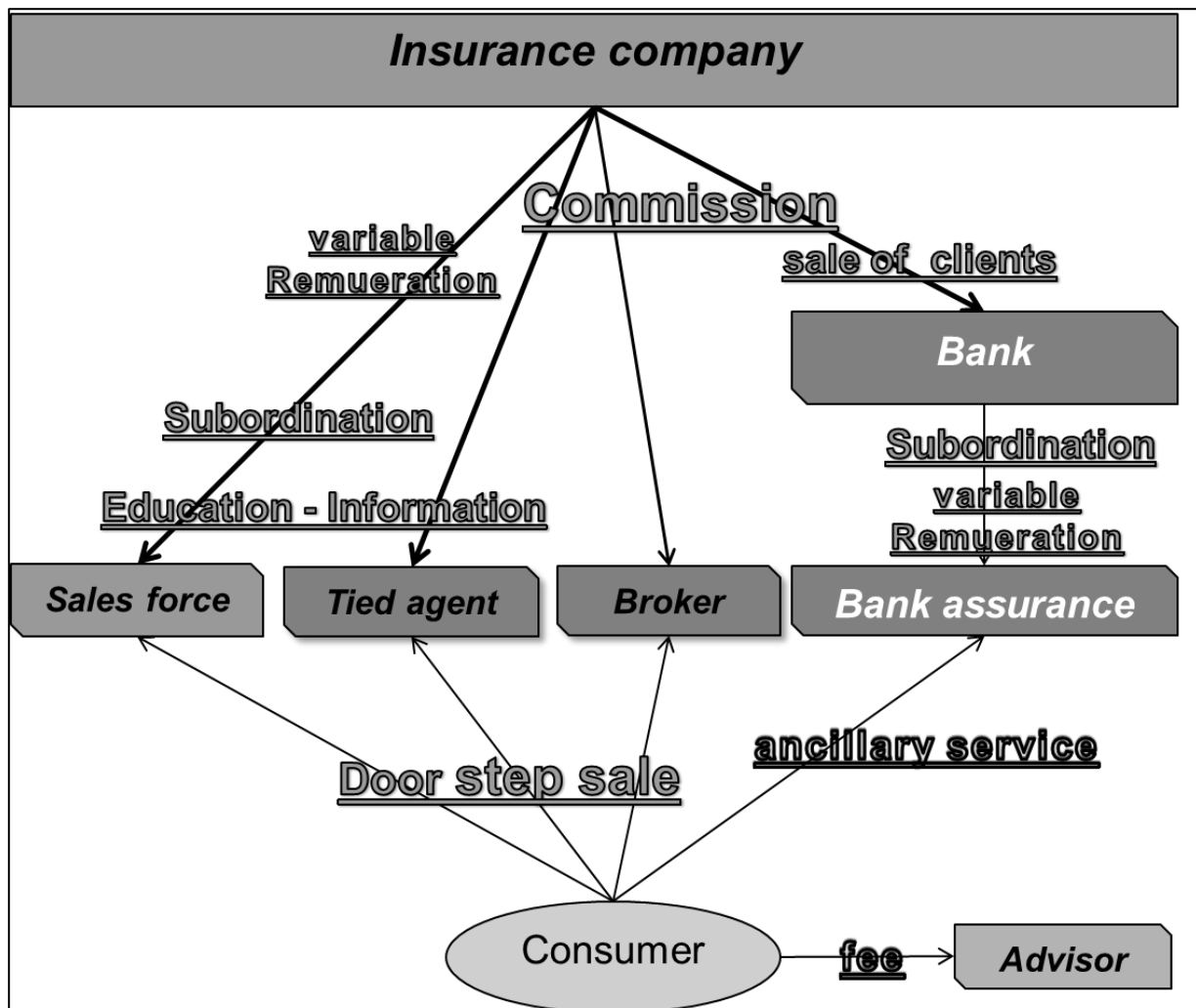
94 Franke, Nikolaus; Funke, Christian; Gebken, Timo; Johanning, Iutz (2011): Provisions- und Honorarberatung. Eine Bewertung der Anlageberatung vor dem Hintergrund des Anlegerschutzes und der Vermögensbildung in Deutschland, p.26.

95 „(3a) Ein Wertpapierdienstleistungsunternehmen darf die Anlageberatung nur dann als Honorar-Anlageberatung erbringen, wenn es ausschließlich Honorar-Anlageberatung erbringt oder wenn es die Honorar-Anlageberatung organisatorisch, funktional und personell von der übrigen Anlageberatung trennt. Wertpapierdienstleistungsunternehmen müssen Vertriebsvorgaben im Sinne des Absatzes 1 Nummer 3a für die Honorar-Anlageberatung so ausgestalten, dass in keinem Falle Interessenkonflikten mit Kundeninteressen entstehen können.“ New Article 33 (3a) Investment Law.

96 New Article 34 h Industrial Code (Gewerbeordnung).

97 The project researchers learned in the discussion of the proposal with the FSUG and the EU-Commission during the kick off meeting that especially within the FSUG different opinions on this subject exist which also influence the interpretation of the project goals. This concerned the consumer approach where some members emphasized that consumers are investors so that investor`s protection would be the core element of this project. This concerned also the conflict of interests where some members held that finding an answer to the question why fee advice systems have so little popularity would already solve the problem. The research will stick to the ToR as the core document for the project not only because it provides the necessary clarity and security for its work but also because its descriptions are wider in so far as consumer protection includes investors` protection and a focus on dependencies with regard to good advice includes also the conditions for fee based systems.

Figure 22: Commissions and the distribution channels



Source: own presentation

There are only very few insurance intermediaries or insurance advisers giving fee-based advice in Germany.

The identification of consumer problems caused by remuneration systems is less obvious than the public discussion assumes. Since each consumer is alone in charge of the identification of his or her own needs objective definitions of consumer problems will always face the reproach of paternalism. On the other hand consumer problems can also not be left to the discretion of each individual consumer who might have unacceptable or exaggerated standards for the satisfaction of imagined needs.

In the following report on consumer problems linked to remuneration system in insurance intermediation we therefore apply two different standards: an objective standard set by the rules of a competitive market economy which promise consumers to have a fair chance to make an informed decision to choose the most suitable and affordable product in a competitive environment. In this category fall all forms of mis-selling and misrepresentation as well as forced sales and hidden conditions of the sale. On the other hand consumer wishes are taken into account in so far as they can be linked to objective consumer needs and are accepted either by law or through a sufficient high number of consumer complaints in complaint boards but also in the public opinion.

3 Problems: how does it affect consumers?

Consumer problems caused by remuneration systems in insurance intermediation are less easy to identify than the public debate assumes. Because only the individual consumer can identify his or her own needs, objective definitions of consumer problems will always face criticism as paternalism. On the other hand, consumer problems cannot be left to the discretion of the individual consumer, who might have unacceptably low or exaggerated requirements for the satisfaction of their needs as they define them.

In this report, we therefore apply two different standards: an objective standard set by the rules of a competitive market economy which promise consumers a fair opportunity to make an informed decision as to the most suitable and affordable product. All forms of mis-selling and misrepresentation, as well as forced sales and hidden conditions of sale fall into this category. Secondly, consumer wishes are taken into account to the extent that they can be linked to objective consumer needs and are either accepted by law or have generated a sufficiently high number of consumer complaints to complaint boards and in public opinion.

3.1 Surveys on problems of intermediation in financial services

Empirical studies on commission-based remuneration in EU countries provided the following evidence as to conflicts of interests:

3.1.1 Life insurance

Van Dijk et al. (2008)⁹⁸. This study was based on a sample of 368 buyers of life insurance in the Netherlands, having invested in 562 products during the period 1975-2005. It concluded that:

- (1) Customers buying insurance directly from an insurance company were able to achieve a better fit with their preferences than those who sought advice from a broker or financial advisor.
- (2) Buying an insurance contract using the services of a broker or financial advisor had a significant negative impact on the pay-out of the life insurance for the customer.

Van Dijk et al. explain their findings by the specific remuneration arrangements as between broker and financial advisor, and by the incentive schemes favouring the interests of insurance companies. These findings suggest that a more customer-focused service by brokers would be achieved by the use of independent financial advisors acting as agents for customers. To ensure the effectiveness of the principal-agent relationship, the broker's remuneration must be paid by the purchaser of the insurance.

Stiftung Warentest in Germany regularly conducts online research of 600 life insurance customers. The results of this research can be summarised as follows:

- (1) Only 20% are satisfied with their contract.
- (2) 33% want to change the life insurance contract.

This finding was confirmed by the research of Oehler (2011).⁹⁹ According to Oehler, 75% of all insurance contracts with a contractual time horizon of 30 years were redeemed

⁹⁸ van Dijk, Machiel; Bijlsma, Michiel; Pomp, Marc (2008): The price of free advice. In: Applied Economics 40 (14), 1889–1903.

prematurely, those with a contract duration of 20 years were terminated early in 55% of cases. The main reasons for early termination were low guaranteed interest payments and low surpluses. This may result from inefficient product design by insurance companies and/or inappropriate financial advice.

3.1.2 Payment protection insurance

Payment protection insurance is credit insurance. PPI is a specific form of income protection to cover the risk of not being able to repay financial obligations, and is an insurance product designed to cover a mortgage or a consumer loan.¹⁰⁰

The **financial supervisor at EU level** in charge of insurance products, EIOPA, issued an Opinion on Consumer Protection Issues in Payment Protection Insurance on 28 June 2013, containing a statement about a product class intentionally designed and sold severely to compromise consumer interests, which has left millions of consumers unknowingly unprotected. The report highlights the problems with PPI and the regulations introduced by Member States to address them. The most frequent problems are issues of eligibility/suitability and the provision of misleading information.¹⁰¹ In addition, consumer choice is further distorted by what regulators refer to as “market imperfections”, namely the fact that PPI is often sold together with the loan products (cross-selling), and that consumers do not have comparable information. While not all regulatory initiatives to date have acknowledged the role that financial incentives may have played in exacerbating this problem, sufficient specific examples of sales push have been identified. The role played by commissions was highlighted by EIOPA’s Chairman Gabriel Bernardino when he explained:

“We have observed in certain countries the emergence in the PPI market of business models where market power of certain distributors led to disproportionate levels of commissions, often as high as 80% of premiums paid by consumers. This and other practices have led to considerable consumer detriment and have been subject to regulatory and supervisory action. With this Opinion EIOPA intends to obtain a clear picture of the reality in all the EU countries in order to better protect consumers and promote regulatory and supervisory convergence.”

In the **United Kingdom**, PPI has clearly shown the importance of taking consumers seriously. “Not so long ago, it was the golden goose of financial services. Banks were making 70% margins on the back of a product with a 0.15% claim ratio. Gross sales had reached around £56bn. PPI was a money-making machine, coughing out the pound coins faster than they could be picked up. But when you looked across the market as a whole, when you look at the claims ratio, the profits and the sales incentives, PPI was quite clearly a disaster for customers and that’s why it’s become a disaster for banks.”¹⁰²

99 Oehler, Andreas (2011): Das Ende vom Anfang einer Vorsorge: Milliardenschäden durch fehlgeleitete Abschlüsse von Kapitallebens- und Rentenversicherungen. Universität Bamberg. Lehrstuhl für Finanzierung.

100 The risks covered by PPI mainly include accident, sickness and unemployment, and for certain products life as well, although life coverage through PPI differs from standard life insurance in that it is adjusted to the loan contract (mortgage insurance generally includes life coverage and contracts often have banks as beneficiaries). PPI is very closely related to life insurance as it pays off the whole debt in case of death. The main difference with a mortgage protection insurance product is that its price may vary according to the borrower’s status and circumstances. There are national differences to take into account e.g. in Ireland mortgage PPI does not include life cover (borrowers purchase a separate life insurance policy when taking out a mortgage).

101 In these cases, for example, consumers are either unable to claim benefits, because their individual situation is not covered by the policy, or they have not yet received the necessary information on which to base their choice.

102 Source FCA, 2013: Speech: The institutionalisation of customer service, 12/03/2013, Martin Wheatley, <http://www.fca.org.uk/news/speeches/the-institutionalisation-of-customer-service>

The gross written premium of PPI sold in the UK in the years 2001-2009 inclusive was around £34bn⁸², although sales at lower volumes had taken place throughout the 1990s. Analysis by the UK Competition Commission (CC) showed that pre-tax profits for distributors of PPI of between 50 and 60% of the GWP sold were achieved in the years 2003-2007. These profits reflected high levels of commission for the intermediaries, and often profit-sharing arrangements with the insurer as well.

A market study by the CC found that the claim ratios were between 11 and 28 per cent of the gross written premium, depending on the product.

In August 2010, the FSA published the following policy statements: Handbook text (Guidance and Evidential Provisions) and supporting material as to fair assessment and, where appropriate, redress of PPI complaints (including examples of fair redress calculations); statements on root cause analysis of PPI complaints and firms' obligations toward non-complainants potentially affected by recurrent sales problems; an open letter listing common failings in PPI sales; the letter reflected the concern that one reason many firms are not handling PPI complaints correctly is that they are not applying the appropriate standards for the sale of this product.

Twenty-six of FSA enforcement actions relating to PPI during the period 2006-2012 concerned poor PPI selling practices (the largest fine was £7million). Two other cases (in 2013) concerned failings in the handling of complaints about PPI sales (the largest fine was £4.3million). According to FSA statistics, firms have refunded (paid out compensation) over £8.9 billion since January 2011. The FSA also issued guidance on PPI consumer contact letters in July 2012, describing what the FSA's considered would amount to fair and clear content in the communications sent by distributors to customers who they think may have been affected by recurrent sales failings.

As a result of two market investigations into the distribution of PPI by the **Italian Authority** (ISVAP, now IVASS) in 2008 and 2011, high commissions were specifically identified as problematic. The later study found that policies distributed by banks or financial intermediaries had higher commission rates (44% on average with a maximum of 79%) compared to policies distributed by agents (20%).¹⁰³

In 2010, a specific disclosure regulation for PPI policies had already been introduced in the form ISVAP Regulation 35/2010. This set out the obligations of providers in terms of information provision and the advertising of insurance contracts (ISVAP Regulation N. 35 Articles 49-50). Costs disclosure in the pre-contractual Information Note and in the policy itself includes disclosure of the commission payable: "the undertaking must show all costs to be borne by the debtor/insured, and state the average paid to the intermediary as commission."

In addition, there are also rules prohibiting conflicts of interest as a way of influencing the availability of offers at the point of sale. In Italy, loan providers are thus not allowed to be both beneficiary and distributor of the insurance contract, because this conflicts with the distributor's duty to act in the best interests of the consumer.¹⁰⁴ Furthermore, as reported

103 Other findings of the study where problems with tying (non-mandatory PPI but banks treat it as a precondition to obtain the loan), single premiums, and advice not in the best interest of the consumers.

104 ISVAP regulation No. 553 of 2006 contained a general conflict of interest provision in its original form, stating that intermediaries must avoid operations that will lead to conflicts of interests, including "those deriving from group relations, own business relations or from relations with companies of the group". This provision was further enhanced by the ISVAP in December 2011 as an explicit prohibition was added, stating that "it shall be prohibited for intermediaries to directly or indirectly become, (...) at the same time beneficiary and intermediary of the relevant individual or collective contract".

in the Chapter on regulation below, Italy has introduced provisions affecting the comparison of competing PPI offers.¹⁰⁵

In the **Netherlands**, however, product regulatory measures such as maximum fees for PPI advice have been introduced. This self-regulatory price cap was found to be necessary when it was observed that intermediaries had tried to circumvent the ban on mortgage and consumer credit advice fees by charging excessive fees for PPI advice. The main problem identified in the Netherlands was consumers' inability to differentiate between good-quality and poor-quality products and services, enabling product providers to develop lower quality offerings (e.g. single premium mortgage PPI and general failings in PPI sales by intermediaries). The Netherlands Authority for the Financial Markets (AFM) carried out thematic work on PPI in 2009 and 2010 and failings in the advice process were found to include unsuitability of products, lack of information (e.g. calculations not based on the client's personal circumstances) and, more importantly, the existence of illegal commissions. The commissions paid by the product provider were found to be in breach of the inducement rules and thus not in the interests of the client.

In 2012 and in the first half of 2013 the AFM examined the fees charged by independent advisors for PPI advice. The study focused on PPI sold with consumer loans through advisors; the AFM found that in some cases the fees were a significant amount and not in the interests of the consumer.

The AFM found that advisors used the fees earned from PPI advice as a tool to safeguard their business model. This was done by advising consumers on PPI and (in a relatively limited percentage of cases) mediating in the purchase of one or several PPIs. Advisors charged very substantial fees (the market average seemed to vary between €1,000 and €1,500, with some intermediaries going as high as €3,000 or even €4,000). Detailed discussions with individual market players confirmed that the fees charged were disproportionate to the effort on advice and intermediation of PPI and as such had to be seen as a disguised (and illegal) fee for advice and intermediation in consumer loans.

In addition, it was found that advisers misled consumers. As a result, consumers wrongly believed 1) that the advisor's fee was linked to the loan (the advisor directly or indirectly led them to believe that the fee due to the advisor was related to advising and mediating a suitable loan. Consumers appeared to be unaware that the fee payable was only related to the work the advisor carried out in terms of PPI advice); and 2) no or limited added value for consumers from PPI (PPI was merely being used to charge a disguised fee for the intermediation of consumer loans and is actually often not purchased by consumers. In these cases consumers merely pay a fee for the advice and do not receive any added value at all. In a substantial number of cases, where PPI is in fact purchased, the relatively limited amount of the loan means that the benefits of PPI are less than the advice costs).

3.1.3 Mortgages

The stakeholder survey conducted by Europe Economics in 2007 shows that the main source of consumer detriment in credit markets is the recommendation of products that are either unsuitable for the borrower's personal circumstances or not price-competitive.

¹⁰⁵ The decree law N.1 of 24.1.2012, converted into law N.27 of 24.3.2012 contains provisions to stimulate competition regarding life insurance linked to mortgages and consumer credit. The new rules provide that if the banks or other financial intermediaries issue a life insurance policy before they will grant a mortgage or a consumer loan, they must give the client at least two additional free estimates of two different providers (independent from the loan provider). Customers may also choose another life insurance from a different provider which the banks or financial intermediaries must accept without changing the terms originally offered for the mortgage or consumer loan.

This seems systematically to be caused by conflicts of interest arising from commission-based remuneration and is particularly relevant and financially significant in residential mortgage markets, where the intermediaries' role in market matching and reducing information asymmetry to consumers is very high and volume-based commissions prevail.¹⁰⁶ The perceived significance of consumer detriment caused by the recommendation of non-competitive products or overcharging is higher in member states where tied mortgage intermediaries dominate than it is in those with a higher percentage of non-tied intermediaries. This may be explained by the limited market searching contribution of tied intermediaries. In contrast, countries where non-tied intermediaries are in the majority are perceived as having far more exposure to the recommendation of inappropriate products. This reflects the fact that non-tied intermediaries have less knowledge of specific products because they have less product education and training than do tied intermediaries, or that consumers are more inclined to follow the advice of non-tied intermediaries, because they expect them to provide impartial advice, even if this is not the case because of the disincentives created by commission-based remuneration.¹⁰⁷

3.1.4 Investment services

A study based on more than 1,200 mystery shopping trips for **investment services** at banks and independent financial advisors across 27 EU Member States found evidence of mis-selling, which may be due to remuneration structures, but other factors may also be at play. The main results were¹⁰⁸:

- *Due diligence*: Less than 10% of advisors adhered to all the MiFID guidelines on due diligence. Advisors often gathered only basic information as to the shopper's profile, and efforts to gather more in-depth information about customers' financial knowledge, investment experience and financial situation were absent. Most advisors overlooked the customer's level of education and profession and seemed to be more interested in the possible level of investment than in the customers' ability to finance that investment.
- *Information transparency*: The explanation of risk by the advisor was not comprehensive and was sometimes misleading. Remuneration fees and investment costs were only partially disclosed. Over 70% of advisors provided some information on fees and thus seem to meet the MiFID requirements. However, it was unclear whether all the "relevant" fees were accounted for, because information on the incentives actually in place was lacking. Most shoppers were informed about upfront product charges (70%), but only partially about other investment fees. Information on advisors' remuneration was discussed in only 30% of cases. "While it is possible that the lack of disclosure on remuneration may be due to the fee structure of the investment firm (e.g. fees based on the dispensing of advice, rather than by transaction), this may be more an exception than the norm, since it is quite common in the retail investment industry not to charge customers

106 Europe Economics, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H) Contract ETD/2007/IM/H3/118 Final Report 15 January 2009, pp. iii.

107 Europe Economics, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H) Contract ETD/2007/IM/H3/118 Final Report 15 January 2009, pp.123.

108 Synovate (2011): Consumer Market Study on Advice within the Area of Retail Investment Services – Final Report, Prepared for: European Commission, Directorate-General Health and Consumer Protection.

directly for advice but for customers to pay indirectly through distribution fees, commissions, and other inducements, etc.”¹⁰⁹

- *Conflicts of interest:* Less than 5% of advisors mentioned conflicts of interest or inducements. Because receipt of inducements may be common in certain products or markets, this lack of disclosure is likely to indicate a violation of MiFID rules. The lack of disclosure as to specific conflicts of interest may mean that investment firms are satisfied with the measures adopted to manage conflicts. However, it is not the role of disclosure to address such an issue, but to help customers understand potential problems of which they may be unaware. Advisors mostly seemed reluctant to discuss the commission related to the investment when they were asked the question “Do you receive any incentive for the recommended products?”¹¹⁰ Thus, “...the study could infer that it is likely that a number of firms may have failed to comply with MiFID requirements in these aspects, since it seems highly improbable that almost all firms do not receive inducements from third parties, or have sufficiently managed all conflicts of interest.”¹¹¹
- *Product suitability:* About 57% of investment recommendations covered by MiFID may be considered broadly “unsuitable”, i.e. did not fulfil shoppers’ needs regarding investment liquidity and risk level. Over 80% of the “unsuitable” cases were due to the relatively high level of investment risk of the proposed products.¹¹² The incidence of “unsuitable product recommendations” tended to be highest in countries with more developed financial markets, such as Denmark (68%), Finland (56%), Netherlands (52%), Sweden (58%), and the UK (55%). In contrast, the recommendation of “safe” investments such as savings accounts (although the shopper scenarios were designed to steer advisors towards MiFID investments) was especially evident in countries such as Cyprus, Greece and Spain. Product suitability also varied across types of financial players (see Table 16). Independent financial advisors tended to propose riskier investments than banks which, however, tended to recommend their own investment products. While about 80% of investments recommended by banks were their own products, 83% of recommendations made by independent financial advisors were for products from other financial institutions. Whether this is due to a wider range of products independent financial advisors can choose from or to wrong incentives remains an open question, as information about internal incentive structures and the remuneration of financial advisors is not available.¹¹³

Summing up, previous evidence on both credit and investment markets shows that non-tied intermediaries recommend inappropriate products more often and this market failure

109 Synovate (2011): Consumer Market Study on Advice within the Area of Retail Investment Services – Final Report, Prepared for: European Commission, Directorate-General Health and Consumer Protection, p.9.

110 Synovate (2011): Consumer Market Study on Advice within the Area of Retail Investment Services – Final Report, Prepared for: European Commission, Directorate-General Health and Consumer Protection, p.9.

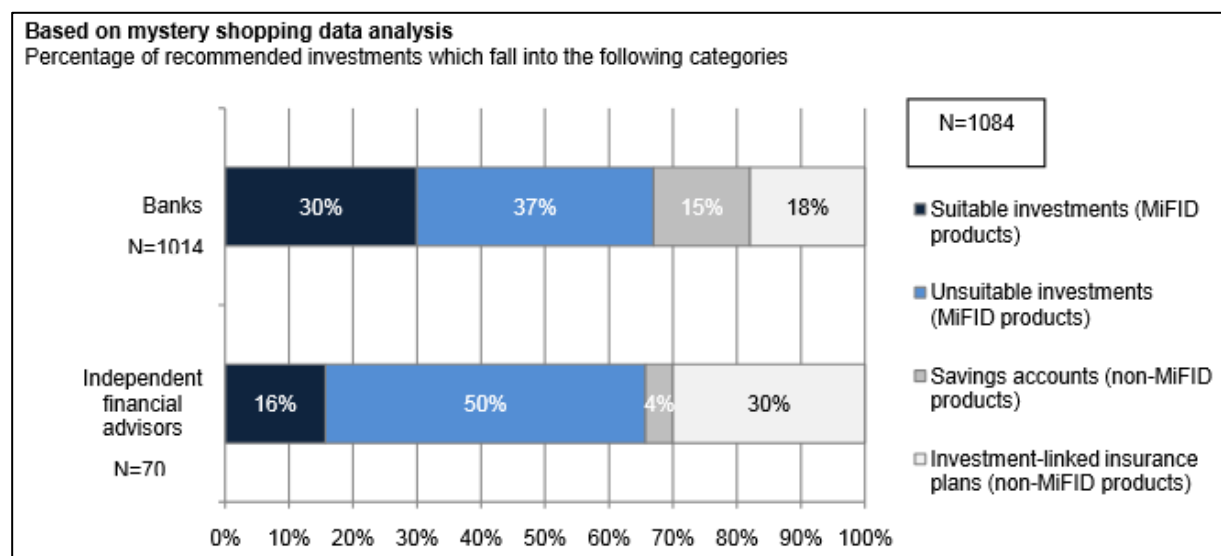
111 Synovate (2011): Consumer Market Study on Advice within the Area of Retail Investment Services – Final Report, Prepared for: European Commission, Directorate-General Health and Consumer Protection, p.10.

112 Synovate (2011): Consumer Market Study on Advice within the Area of Retail Investment Services – Final Report, Prepared for: European Commission, Directorate-General Health and Consumer Protection, p.11.

113 Synovate (2011): Consumer Market Study on Advice within the Area of Retail Investment Services – Final Report, Prepared for: European Commission, Directorate-General Health and Consumer Protection, p.12.

seems to be most severe in member states where these intermediaries have dominant market shares.

Table 16: Types of investment recommendations across intermediaries



Source: Synovate (2011): Consumer Market Study on Advice within the Area of Retail Investment Services – Final Report, Prepared for: European Commission, Directorate-General Health and Consumer Protection, p.89.

In the UK, Charles Rivers Associates Ltd. (2002)¹¹⁴ tested 179 **financial advisory services** and the quality of recommendations. The mystery shopper had knowledge of the optimal product for the customer and the exercise revealed that:

- (1) 81% of advisors selected the optimal product, but of the 19% who selected an inappropriate product for their client, 79% were independent.
- (2) Only 9 of the 179 financial advisors surveyed chose an inappropriate insurance product for their client, despite the fact that the provision offered for inappropriate products was double the amount of the optimal product. As before, the majority of advisors recommending an inappropriate product was independent (Charles River Associates Ltd 2002, p.31).¹¹⁵

The results suggest that the temptation to provide inadequate advice is strongly influenced by the remuneration scheme in place.

In Austria, the big investor scandals emerging when the real estate bubble burst, severely affecting small investors, have shown that real estate securities (shares, certificates) had been distributed aggressively through structured sales (e.g. 6% initial commission plus a total of portfolio commissions of between 15 and 40 per million on real estate securities).¹¹⁶

Attractive initial as well as portfolio commissions created enormous pressure to sell and led ultimately to flawed advice and ill-judged purchases by small investors).¹¹⁷ The

114 Charles River Associates Ltd (2002): Polarisation: research into the effect of commission based remuneration on advice. study for the Financial Services Authority. London.

115 Charles River Associates Ltd (2002): Polarisation: research into the effect of commission based remuneration on advice. Study for the Financial Services Authority. London, p.31.

116 Source: Fonds professionnel, "Die Branche feiert", 26.3.2003.

117 <http://help.orf.at/stories/1716290/>

Austrian Chamber of Labour has recorded a large number of investor complaints and conducted test trials and settlement negotiations, which have led to payment of compensation by providers.¹¹⁸

3.2 Mis-selling of insurance (*iff* survey)

Mis-selling is not easy to measure and can take various forms. The literature suggests that there are five different types of unproductive sales causing consumer detriment, all of which may be incentivised by the additional income from commissions directly linked to legally independent contracts and the amount of coverage sold. These are churning, twisting, overcharging, forced bundling and inflated products. As the following responses to our survey show, all these problems exist in the market place. They do not, however, appear to be typical of insurance contracts alone, and apply to all services sold through intermediaries, and credit services in particular. As we can assume that respondents to the questionnaires were all well informed about their national markets, it is noteworthy that, given the differences in national marketing practices, on average only about half of respondents could report of mis-selling practices as a problem at national level.

3.2.1 Artificially increased prices

Churning occurs where distributors take advantage of consumers through unreasonably frequent turnover of their deposits. This was one of the most reported problems in our survey and in the literature; however this phenomenon may vary depending on the type of financial services investigated.

23% of respondents said this was also a problem witnessed as a practice in their country (e.g. FI, IE, IT, SI), while a significant majority did not have or were not aware of it at least in insurance (e.g. respondents from DK, DE, FR, FI, NL, PL, UK).

Examples¹¹⁹ of comments provided to our semi-closed questions illustrating this:

Ireland: Customers are often told that their investment is not doing well and that they would be better off switching to a different manager. Of course, there is no data on this. (CA, website)

Ireland: Churning for insurers can be called rebroking from an intermediary's perspective. In Ireland we have had a term war with prices reducing significantly in recent years. This business is often rebroked to ensure the client is receiving a better result. (TA interm)

Italy: This happened in particular some years ago (2001 - 2), when new life insurance products were offered and in a period of high investment even with reference to the insurance market. This made the intermediaries convince the clients to shift from one contract to new one whereas in some cases the new contract was not more convenient for the clients but only better remunerated for the agent. (Legal Expert)

Twisting designates a practice whereby distributors take advantage of consumers through unreasonable contract renewals in order to earn additional commissions. Again about half of respondents reported this problem in their country.

18% said that they had often encountered examples of distributors taking advantage of consumers (DE, FR, UK, SI); 27% had had some experience of the 'twisting' problem (AT, DK, FI, FR, IT) and 50% were not aware of it (e.g. DE, FR, IE, FI, NL, PL, UK). (Respondents n=22)

Commentaries describe this problem as follows:

France: Some intermediaries, and insurers as well, take advantage of the legal framework on re-conduction of contracts. In some contracts, they do not have to notify the re-conduction, so consumers

118 <http://helpv1.orf.at/index.html@story=10515>

119 See Annex-table Q50.

are unable to end the contract before the next re-conduction, one year later. This is often the case for insurance granted by telephone and healthcare insurance.¹²⁰ Le système de la tacite reconduction annuelle est quasi systématique en assurance. Le consommateur est enfermé dans une fenêtre de résiliation très étroite qui entrave sa possibilité de pouvoir faire jouer la concurrence (notre législation sera bientôt modifiée sur ce point et le changement d'assureur sera facilité) (CA)

Slovenia: Automatic renewal of contracts (opt-out system), about which the consumers are not notified properly (CA)

Overcharging: Insurance markets are imperfect due to a lack of transparency, the complexity of products, the difficulty of assessing the amount of coverage required and the limited experience of consumers in the purchase of a product which may last for their entire life. While our objective data show that there are enormous differences in commissions for different products and services, respondents were divided about this.

32% found evidence against, and 32% had not experienced this problem.

Poland: In Poland unit-linked insurance is sold with a high commission but the product itself does not guarantee any profit for the consumer or even getting the money paid back. (CA)

Germany: Payment protection insurances have far too often turned out to be neither reasonable in protection nor in pricing. In relation to a normal term life assurance, the price of the premium is extraordinarily high. One reason for that is the amount of commission paid to the distribution channel. There are credit institutions earning more money by commissions on PPI than by the interest rate for the consumer credit. (CA)

Ireland: In many packaged products it is impossible for a consumer to verify what has been charged. Experience from banking would suggest overcharging is quite likely (Other CA)

Italy: For example, in one of our surveys that we attach a cover PPI was made to pay 21,000 Euros to secure a loan of 175,000 Euros (CA)

Slovenia: Many insurance products in Slovenia are relatively more expensive than similar products in other countries. In our research we have noticed this issue especially in risk life insurance. Investment life insurance is often similarly priced as in other countries, but contains relatively less for the same price. (CA)

3.2.2 Inflated products

Where the commission is based on the amount of money involved in a financial service product there seems to be a strong incentive to sell larger amounts than needed. This could be far too much coverage, a savings product where consecutive savings exceed ability to pay or the coverage of non-existent risks or risks the consumer could easily carry himself, considered in the round, save the administration cost of the insurance. But the phenomenon seems to be less widespread than assumed. Only 9% had had examples of distributors taking advantage of consumers, for example through 'inflated products' (e.g. IT, UK), 32% had partly experienced 'inflated products' (e.g. AT, DE, FI, IE, IT, NL, SI), but 59% had not encountered or were not aware of such problems (e.g. DE, DK, IT, FR, IE, FI, NL, PL, UK).

Germany: Selling three unit-linked life insurances (with the same portfolio of investment funds!) to spread the risk. (CA)

Netherlands: We see this for example with funeral insurance products (Authority)

Slovenia: Especially in cases of life insurance. (CA)

Tying and bundling appears to be the most significant form of mis-selling. It is known by marketers as cross-selling and seen as an important tool for maximising income from the provision of certain basic services like bank accounts, car insurance and deposit accounts, which alone seldom sufficient return to cover maintenance of the service, especially for people on lower incomes. This is why bundling and cross-selling must be considered from different aspects. On the one hand they maintain certain services through cross-subsidy,

¹²⁰ For further information on termination of insurance contract follow the link: http://www.conso.net/page/bases.5_vos_droits.1_conseils.6_fiches_pratiques_web.4_la_resiliation_du_contrat_d_assurance.

and the same customers both pay and benefit. On the other hand, they are used to force certain customers into unnecessary and expensive contracts. While the first practice is arguably acceptable, the second is not.

Because we asked experts and stakeholders to identify major problems for consumers rather than provide their opinion, we conclude that the significant number of respondents and the surprisingly high number of comments suggest that forced bundling may often be incentivised not by cross subsidies but by taking advantage of consumers trapped in a specific product. This is especially the case for Payment Protection Insurance, which was perhaps the biggest insurance scandal for 20 years in the UK, Netherlands, France and Germany. The divergent opinions with regard to products and level of incidence in France highlight the difficulties in evaluating this problem.

41% of respondents had frequently encountered the problem of distributors taking advantage of consumers through forced bundling (DE, FR, IE, PL, SI, IT, UK), 14% had some experience of 'forced bundling' (e.g. AT, DK, FI) while only 41% had no experience or were unaware of it (DE, IT, FR, IE, FI, NL, PL, UK).

Examples given in numerous comments were primarily of PPI linked to all types of credit, and insurance linked to bank cards, flight tickets, package holidays, spectacles or automobiles. Insurance linked to other insurance was also mentioned frequently.

Excessive Sales: When respondents were asked whether they knew of examples of distributors taking advantage of consumers by "excessive sales", 18% reported that had frequently encountered the problem (e.g. FR, IE, UK), 36% had had some experience of it (e.g. AT, DK, FI, IE, IT, PL, SI), while 37% had no experience or were unaware of it (e.g. DE, FI, IE, FR, IT, NL, PL).¹²¹

3.2.3 Wrong products

Unsuitable products: Distributors sometimes take advantage of consumers by selling "unsuitable products" (sale of products not needed by consumers). 27% of respondents had frequently encountered this problem (e.g. DE, FR, IT, UK, SI), 45% had had some experience of it (e.g. AT, DK, FR, IE, PL) and 24% had no experience or were unaware of it (e.g. DE, FI, FR, IT, PL).¹²² Again PPI was mentioned the most but insurance designed for employees when the purchaser was a freelancer, and an investment for a future pension sold to a retired person were also given as examples.

Concealment: Good products sometimes remain unsold. Only 14% of respondents had frequently encountered this (e.g. DE, FR, IT, UK, SI), 18% had had some experience of the 'concealment' problem (e.g. AT, FI, FR, NL, UK, SI) but 59% had had none (e.g. DE, DK, FR, FI, IE, IT, PL)

Ireland: Companies with direct sales distribution will place or withdraw products not providing sufficient margin for the producer. Other (CA)

Netherlands: Not a single provider offers the fiscally attractive saving program for a funeral. (Other CA)

Confusion between products: When asked for "other problems" special cases such as funeral insurance and life insurance, individual and state pensions, casualty insurance and accident insurance, split tracker bonds were mentioned.

France: Les assurances décès (le consommateur ne récupère pas son argent), peuvent être confondus avec les assurances vie (produits de placement). (CA)

121 See Annex Table Q55.

122 See Annex Table Q56.

Ireland: Individual pensions are a fraught area because of costs and uncertainty regarding with the interaction with State benefits. (Other CA)

Italy: Inadequate contracts in casualty insurance - not adequate contract for personal accident insurance. (Legal Expert)

Ireland Complicated products such as split tracker bonds are designed to confuse people. (Other CA)

3.2.4 Inadequate or lack of disclosure

Variety of products: When an intermediary can only offer one product for a specific consumer need, and that offer is itself unsuitable or too expensive, shifts the problem of mis-selling from the intermediary to the supplier. Regulation targeting intermediaries will not be effective in those circumstances. This kind of problem was reported by more than 50% of respondents.¹²³ Lack of explanation, bancassurance and insufficient legal protection are cited as causes.

Variety of suppliers: This question concerned the legal situation in which intermediaries must disclose for whom they work and whether they are tied to a certain supplier, and will therefore not offer products from other suppliers.¹²⁴

Italy: Relation between credit intermediaries and lenders are not always clear. This also creates problem in case of anticipation of the date of resolution of the contracts and with reference to restitution of the intermediary commissions paid. (Legal Expert)

Tied interests: This question was identified with the previous questions and respondents assumed that knowing for whom an insurance intermediary works would help to identify the interests involved.¹²⁵ The responses did not disclose a broader understanding that the type of remuneration and the ownership structure of the company for whom the agent works would also be needed to reveal this potential conflict of interest.

Remuneration of the intermediary: We also asked whether it was made sufficiently transparent by whom, how much and how the intermediary is paid in order to reveal existing dependencies.¹²⁶ The general response was that information about remuneration is never explained to the client orally and seldom explained at all.

Form of Remuneration: The responses indicate that information as to the form of remuneration and whether it was a fee, a contingent commission or a salary is not available anywhere.

Consumer situation and needs: A small majority named lack of evaluation of consumer needs when advising on a product as a problem.¹²⁷

Poland: PPI is sold to anyone who wants to get a credit. (CA)

Slovenia: The agents and intermediaries are generally not focusing on consumer needs and circumstances, but only present the product they are trying to sell, without regard to consumer's personal circumstances. (CA)

Denmark: A customer in DiBa Bank wanted as low risk as possible, but instead got very risky investments. (Legal Expert)

Netherlands: Mostly, it is standardised, but this may lead to a ticking-off culture" where specific circumstances may be forgotten" (Other CA)

123 Often: 20% FR, IE, IE, SI, partly AT, DK, FI, IE, IT, NL, PL 34% See Annex Table Q60.

124 See Annex Table 61.

125 See Annex Table 62.

126 See Annex Table Q63-65

127 Often 18% (FR, IT, SI) partly 36% (DE, DK, FI, FR, NL, PL) 32% not or do not know (AT, FI, FR, IE, IT, PL) see Annex Table Q67.

Involved risks and coverage: Responses were similar with regard to concrete inquiries into the object of the insurance.¹²⁸

France: Nous avons pu vérifier lors d'enquêtes que les consommateurs ont une idée assez vague des garanties qu'ils détiennent déjà, le questionnaire ne permettra donc pas au professionnel de déterminer la couverture existante. (CA)

Italy: This is quite common in health insurance or personal accident insurance, as well as in professional liability insurance. (Legal Expert)

Adequate product: When asked about choice of product, respondents were even more critical. 69% thought that this was often or sometimes a problem. Again, PPI (bancassurance) and tied agents were cited frequently.¹²⁹

Explanation: Most of statements concerned the lack of an adequate explanation of a product (41%). The Dutch authority questioned whether even a sufficient explanation would be understood by consumers.¹³⁰

Germany: Costs are generally not explained. Relevant information received by the consumer after given advice in a large convolute of terms and conditions and other required information. (CA)

France: Le professionnel ne maîtrise pas toujours le contenu de son produit. Le détail exact d'une assurance vie n'est, par exemple, pas toujours simple à obtenir afin de pouvoir juger du risque du placement. De ma même manière, un consommateur insuffisamment curieux découvrira la totalité des frais applicables au moment de la souscription. (CA)

Ireland: Advisors often don't understand the products themselves especially structured products. Other (CA, website)

After-sales problems: Problems which may occur during the lifetime of a contract are crucial to its quality. Surprisingly, this was not raised by the majority of respondents. Either respondents assumed that this was not a priority or they considered that intermediaries provided adequate explanations. Only 18% saw this problem as typical while 36% assumed that it occurred sometimes.¹³¹

Italy: Problems may arise especially at the time when the insured event occurs. (Legal Expert)

Slovenia: Consumers are finding it hard to get in touch with their agents in case of questions after the conclusion of the contract. (CA)

Poland: Usually we see the problems connected with the denial of claims. (CA)

Ireland: unable to contact the sales person particularly in bancassurance. (TA intermediary)

128 See Annex Table Q68.

129 See Annex Table Q69.

130 See Annex Table Q70

131 See Annex Table Q71

3.2.5 Summary table

Table 17: Summary of consumer concerns with regard to remuneration systems

		CREDIT	INVESTMENT	INSURANCE	HOUSING	LABOUR
Service	Remuneration	Volume based	Defined by supplier and product	Product and volume based	Volume based	Variable elements of salary
	Conflicts of interest with	Amount of credit/debt	Independence of advice, volumes	Independence of advice, suitable product, volumes	Low rent, low house prices	Stability of income, own judgement
Problem	Effect	Wrong advice	Inadequate products, bad advice, market distortion, cost for the economy	Unsuitable and subjective advice	Higher prices	Unstable income, reduced freedom
	Information	Separate disclosure of price and dependencies , best advice	Disclosure of amount, dependencies , best advice, analysis of situation and market	Price disclosure	Price disclosure	
Rules	Regulation	Caps, admission, supervision, inclusion into APRC	Admission, Qualification	Refund, time allocation	Caps, no fees where dependency	Fixed income
Market	Alternatives	Direct marketing	Fee based advice	Independent brokers, fee based advice	State run intermediation	Separation of supplier and agents

3.3 Complaints

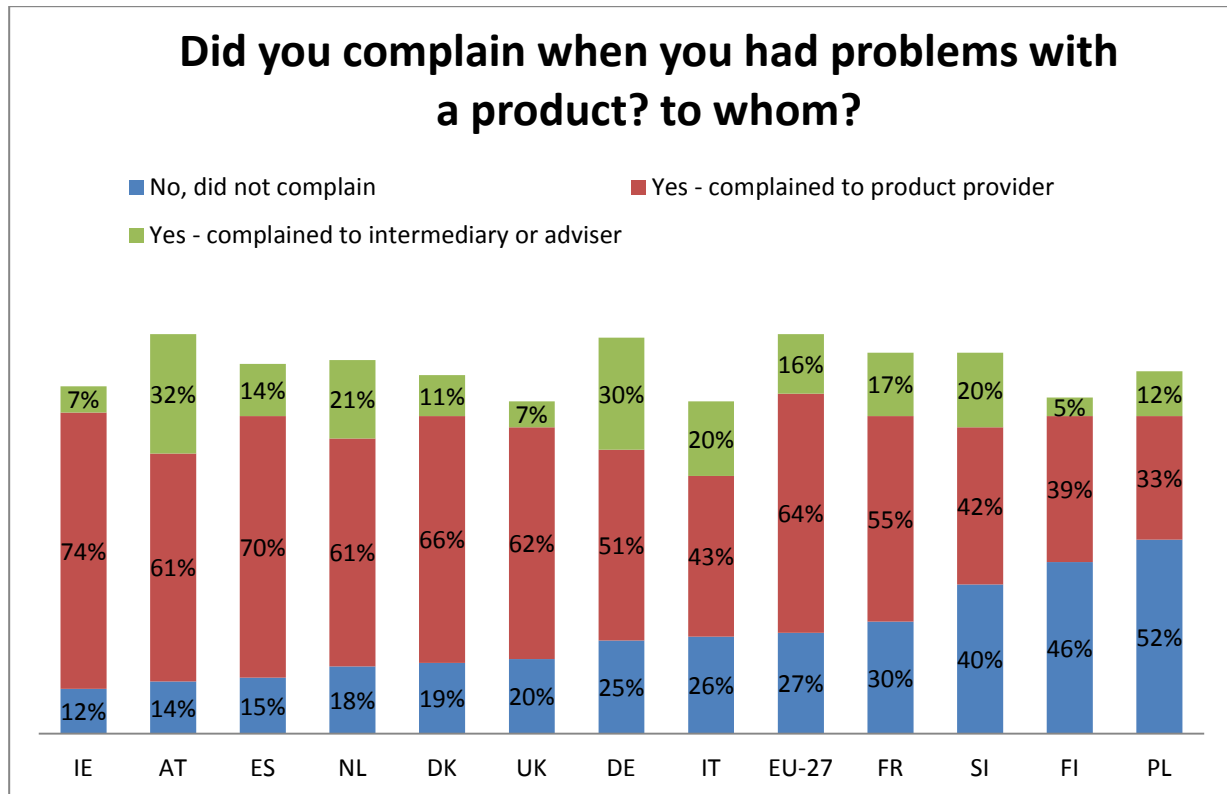
Complaints data should be treated with caution when it is the sole basis for interpreting or inferring consumer detriment. This is because complaints about specific problems or products tend to come in waves as media coverage and awareness of the opportunity to make a claim builds up. Cultural attitudes towards complaining as well as knowledge of consumer rights varies between countries and official data may not reflect the true level of detriment. Nevertheless, complaint boards, ombudsmen and other institutions responsible for collecting complaints data will hopefully become more sophisticated as supervisory authorities and consumer protection watchdogs increasingly put the infrastructure and resources in place to monitor markets with regard to consumer outcomes.¹³²

In addition, the granularity of official statistics needs to be improved in order to enable more meaningful analysis of the sectors and nature of problems.

Figure 23 from Eurobarometer opinion polls shows how the proportion of consumers that do not complain when they experience detriment varies from 12% in Ireland to over 50% in Poland. It is also noteworthy that an average of only 15% of complaints are addressed to intermediaries, suggesting that they may not be, or may be perceived not to be able to resolve problems or provide redress.

¹³² See initiatives like the German "Finanzmarktwächter" led by the German Federal consumer umbrella organisation vzbv.

Figure 23: Consumer propensity to complain and to whom



Source: European Commission, Special Eurobarometer 373, Retail Financial Services, 2012, p.102.

We asked representatives of the participating Member States to provide the total number of complaints recorded, the source of these figures and, if possible, give any additional details. The responses showed that data specific to the activities of intermediaries generally do not exist.¹³³ As the comments below reveal, there are data only on insurance complaints in total and no distinction is drawn between the various channels for those complaints. Such complaints may concern the servicing or quite often the way claims are treated should the covered risks occur. The Dutch financial authority indicated that 629 complaints in 2012 concerned insurance intermediaries while the Slovenian consumer association assumed that about a hundred complaints were made in this area. In their comments they stated that such claims were not differentiated according to distribution channels but only according to the type of services. Often no records are kept at all.

The number of complaints may only reflect existing intermediation problems if they are as crowded with regard to hundreds of thousands of complaints the UK authorities received with regard to the mis-selling of PPI alone. In this case, however, it was the administration itself that defined the problem for the public and offered a remedy on an individual basis. If one "offers a problem solution", many consumers recognise the problem. This was the core message of a project on consumer complaints at the Hamburg Consumer Central from 1983 to 1985, which showed that the proportion of complaints in financial services could be raised from 0.3% to 50% within one year because of actions of that type. There is no incentive to complain if there is no prospect of satisfaction.

Even less information was available as to complaints in other areas of financial services, such as credit and investment. The Finnish authority reported 47, Slovenia "more than 100" while others responded "no data available" or "unknown".

133 See Annex Table Q83.

When we asked about the main problems underlying these complaints¹³⁴ responses did not contain factual information and largely amounted to general statements such as “mis-selling, lack of advice” (Poland, France), late detection by consumers (Germany), problem has shifted to bank services (Denmark), asymmetric information (France), lack of consumer understanding of risks together with poor returns on investment (Ireland), lack of information (Poland, Slovenia) and only in the case of the Netherlands were empirical facts drawn on when “payment protection insurance” was cited.

More detailed information as to the kind of intermediary involved in conflicts which led to a complaint was equally scarce.

The Chamber of Labour in Vienna, together with the Association for Consumer Information in Vienna conducted a survey between 2011 and 2012, analysing about 15,000 complaints related to life insurance. A number of practices emerged which could be linked to insurance intermediation. Making a consumer sign a separate agreement on insurance intermediation for unit-linked life insurances led to a separate claim for fees which amounted to 5,226.60 Euro equivalent to 8% of the total amount of premiums to be paid. This amount had to be returned in 60 instalments.¹³⁵ There was also evidence of a combination of contingent commissions with fees justified by reference to special services.

The following table summarises the information we obtained from four countries (NL, PL, SI, IE). From this it is apparent that capital life insurance leads the list of complaints across all countries, followed by payment protection insurance. Two groups of salespeople are very visible: bancassurance, which plays the core role in both capital life insurance and in PPI and the insurers’ own staff. This is certainly not representative, but it adds at least a question mark to the discussion as to whether the core problems would be solved if brokers’ commissions were regulated. Bancassurance certainly works on the basis of volume-based commissions. But it is barely credible that banks, which are in the main more powerful market players than insurance companies, are induced to mis-selling and false advice merely because of incentives from the insurance industry. Banks have their own separate marketing strategies and, similar to structured marketing firms, often define for insurers the insurance product they want to sell.

134 see at pp 57ff

135 Source: Arbeiterkammer Oberösterreich

Table 18: Insurance complaints by distribution channels and product¹³⁶

SALESPERSON	CAPITAL LIFE	HEALTH	CAR	PPI	CTRY
Employee	127		83		NL
	8	5	10		SI
Tied Agent	8	5	3		SI
			4		PL
Linked Agent	15	10	2		SI
	15		33		PL
Broker	10%	5%	5%	5%	IE
	15				PL
	15		10		SI
Bancassurance	202			543	PL
	7				SI
Advisor	135				PL

¹³⁶ The following references have been added: for Germany <http://www.versicherungsbund.de>, for Ireland Financial Services Ombudsman: "very little complaints are made to our financial services ombudsman in respect of brokers"; for the Netherlands: Figures represent # of complaints recorded by the supervisor. Not the # of complaints by the financial institutions themselves or the Dutch complaints institute. Poland: "Private health insurance is not popular in Poland. PPI is sold only through bancassurance channel."

4 Intermediaries: Who is promoting, selling and advising?

The existing body of EU law provides two approaches to intermediaries. First the law provides a general definition of insurance intermediation in Article 2 (3) covering all *activities of [advising on] proposing or carrying out other work preparatory to the conclusion of contracts of insurance, concluding such contracts, or assisting in the administration and performance of such contracts, in particular in the event of a claim, [and the activity of professional management of claims and loss adjusting]*.¹³⁷

This approach has replaced the previous legal definition of intermediation as a form of brokerage.¹³⁸ The new economic approach now includes tied agents (Article 17 (1) of IMD II) as well as dependent labour *if carried on by an insurance undertaking without the intervention of an insurance intermediary*.¹³⁹ This broad definition leads to the identification of those professions for which certain remuneration schemes may cause a conflict of interest.

4.1 Professions and sales persons involved

4.1.1 Who is an intermediary?

The law does not provide clear guidance which professions should be qualified as intermediaries which have replaced the traditional reference to *brokerage*.¹⁴⁰ Instead the word *Agent*¹⁴¹ used to describe conflicts of interests in the parallel world of investment services¹⁴² is still only mentioned in the recitals of IMD II.¹⁴³ Although the conflict of interest an intermediary or agent may be exposed too is similarly defined in both

137 Those elements in bracket amend IMD I.

138 Title 10 Brokerage contract of the German Civil Code requires an own contract between intermediary and client. It further states in section 652: (1) A person who promises a brokerage fee for evidence of the opportunity to enter into a contract or for negotiating a contract is obliged to pay the fee only if the contract comes into existence as a result of the evidence or as a result of the negotiation of the broker. If the contract is entered into subject to a condition precedent, the brokerage fee may only be demanded if the condition is fulfilled.

139 The old version in IMD I read as follows: These activities when undertaken by an insurance undertaking or an employee of an insurance undertaking who is acting under the responsibility of the insurance undertaking shall not be considered as insurance mediation.

140 Recital 4 of IMD II refers to various types of persons or institutions, such as agents, brokers and Bancassurance operators (which) can distribute insurance products. Recital 5 distinguishes between insurance agents and brokers indicating that an agent may be an intermediary which is directly connected to the supplier side in any form.

141 Recital 5 of IMD II distinguishes between insurance agents and brokers where the first is directly connected to the supplier side. Article 6 (1) (e) IMD II refers to agents which the intermediary intends to use. The explanatory memorandum of IMD II (1.) refers to all financial services provider and agents that deal directly with consumers (G20 Principles).

142 Article 4 (21) MiFiD II defines a `tied agent` as a natural or legal person, who under the full and unconditional responsibility of only one investment firm on whose behalf it acts, promotes investment and/or ancillary services to clients or prospective clients, receives and transmits instructions or orders from the client in respect of investment services or financial instruments, places financial instruments or provides to clients or prospective clients in respect of those financial instruments and services; ... (recalled in Article 16 (2))

143 The explanatory memorandum to IMD II 3.5 Chapter IV refers expressively to the principal – agent dilemma.

Directives¹⁴⁴ and although in practice an agent may intermediate the sale of insurance as well as of investment products the distinction is upheld throughout the whole regulation.¹⁴⁵

An intermediary is therefore a person that mediates financial contracts with some kind of dependency to the supplier side. Four groups of intermediaries are prone to dependencies in insurance and investment services: own staff, tied agents, brokers and banks (Bancassurance/bank brokerage). No intermediaries in this sense are independent financial advisors, chartered accountants/tax advisors and solicitors.

4.1.2 Classification by professions

The classification of distribution channels differs across insurance markets and countries. An often used classification distinguishes between four types: (1) direct writing via employee sales representatives or mass marketing methods such as call centres or the internet, (2) exclusive agents who offer the product of one supplier only, (3) independent or multiple agents who offer consumers competing products from a wide range of producers, and (4) brokers who have no formal contractual relationships with producers and therefore act on behalf of the consumers. While in the first case, production and sale are vertically integrated, the remaining cases involve the use of financial intermediaries. In the insurance and banking industries, all four distribution channels coexist. If there are close affiliations between banks and insurance companies, where banks are involved in the distribution of insurance products or vice versa, we speak of bancassurance. Banks may distribute insurance products as exclusive agents, independent agents or brokers¹⁴⁶.

A more detailed classification differentiates between (1) direct writing, (2) exclusive agents, (3) independent agents (multiple agents, brokers, sales organizations¹⁴⁷), (4) banks, and (5) tied structured sales organizations. The latter have few product partners and hold fixed contractual relationships with one or few insurance companies, or are owned by them, and are organized through multiple hierarchical levels.¹⁴⁸

The core question of the present study concerns the dependencies of the sales personnel from the supplier side. Volume-based commissions are an expression of such dependencies.¹⁴⁹ They are offered factually by the supplier of insurance but may be based on a legal duty of the consumer to pay the commission.¹⁵⁰ Since this presupposes also an interest of the suppliers to incentivise their own- or outside-sales personnel to sell as much of the existing products as possible and to earn the highest profit, the conflict of interest this sales personnel has, between the interest of the demand side and the supply side, requires a certain degree of independence. These classifications have to be adapted in the light of the degree of independence of a sales person. If the reason of the problem lies in such dependencies, then the classifications used in the solutions should take care of these dependencies. As it has been outlined in the chapter on remuneration, volume-based commissions are only one form of creating dependencies. The variety of instruments

144 See Chapter 1.

145 Article 2 (8) IMD II addresses the similarly defined agent of MIFID II as a 'tied insurance intermediary'.

146 European Commission, Business insurance sector inquiry, Inquiry into the European business insurance sector pursuant to Article 17 of Regulation 1/2003, Interim report, European Commission, Competition DG Directorate D, Unit D 1 Financial services, 2007, p.32.

147 E.g. AWD, MLP

148 E.g. DVAG, Ergo Pro, OVB; see Towers Watson, Vertriebswege-Survey zur Lebensversicherung, 2012.

149 See under 2.1 at pp.52 ff.

150 See Figure 4: Visibility of remuneration models for customers at p.56.

a supplier can use to influence the marketing of his products is in principle unlimited and not specific to financial services. Orders given in labour contracts which require subordination, premiums for performance, group gratifications, commissions, “sticks and carrots”, job promotion, special labour conditions, flexible time, expectations, competitions, additional security through pensions and insurances, praise and blame are all examples of the vast variety of tools available to suppliers.

4.1.3 Multi-Level-Marketing agents

A profession which does not appear as a separate entity in the present classifications used in the law to regulate dependencies, are agents which work for a multi-level marketing organisation (MLM), which in other languages it is called a “structured marketing organisation” (Strukturvertrieb). These organisations address people even without background in financial services and offer them the opportunity to earn money by selling, especially insurance and some investment products. The agent who directly advises the consumer and provides brokerage services may be an employee of the marketing organisation which may or may not pay him a minimum income and provide all the means he needs to be able to sell. But an important element of its income is generated from the income of subordinated agents. This is the reason why it is called a “multi-level” or “hierarchically structured sales organisation”. The practice applied may imply pyramid-selling.

Legally, the single agent has no direct ties to the supplier side. Many of them may be admitted as (independent) brokers if there is no labour relation to the marketing company. If they have a labour-like relation it is not with the insurer. From a traditional viewpoint, where the direct relation between supplier and agent is taken into account, such agents seem to be rather independent.

But dependencies may be even higher and the number of scandals concerning the labour conditions of insurance agents as well as problematic marketing behaviour attributed to them is significant. The dependencies are “structured”.

On the first level, the MLM may be totally owned by an insurance company like AWD¹⁵¹ which was acquired by Swiss life and is now known as Swiss Life Select Deutschland GmbH. The MLMs have contracts of cooperation which exclude, or at least limit, their interest to sell products other than those offered by their contractual partners. The tied relation between the MLM and the insurer is product specific. A MLM may develop products which it assumes to be favourable to their own marketing strategy and which they may impose onto the supplier.

For example, products may be designed especially for tax advantages or subsidies, even where most consumers will not be able to enjoy these advantages only because the agents are trained to sell financial services using the subsidy as a proof of trustworthiness. In their framework relation such MLMs may guarantee certain minimum sales of a product under the condition that certain own conditions are met by the supplier. If the supplier owns the MLM, it has been experienced that even where two different suppliers participate the proportion of products sold for one or the other comes close to the participations.

151 See the homepage of the association of former “employees” of one of the biggest German multi-level marketing company in financial services formerly AWD now with changed name bought by Swiss Life. (<http://verein-der-ehemaligen-awd-mitarbeiter-ev.de/>). For their dependencies see the see Supreme court BGH Decision 28.06.2012 VII ZR 130/11. For more court decisions in favour of the ex-brokers of AWD see http://verein-der-ehemaligen-awd-mitarbeiter-ev.de/?page_id=2

This general dependency may resemble more a cooperation between two suppliers along the value chain where the MLM only overtakes the retail marketing function. The problematic element of MLMs is the high dependencies built into their relation with their agents.

- The agents have extremely weak labour relations if at all. This means that they may be fired at any time without warning.
- Their income may be insufficient, so that they become dependent on credit from their employers.
- Some MLMs provide an initial credit in order to facilitate the purchase of equipment which the MLM assumes to be appropriate and which may be very costly (car, computer, office). The instalments are fixed and presuppose a certain minimum earning per month, which may be difficult to achieve. As a result, agents are under high pressure to sell in a way that short term income is maximised. They are also tied to the MLM in case they want to quit this relation. The loan may be cancelled so that agents become overindebted. The Consumer Credit Directive has excluded such credit from its scope.¹⁵²
- For each level of agents, a minimum amount of units representing the sales have to be reached.

The most important form of dependency is the hierarchy and supervision through fellow agents of the MLM present in the word "multi-level" or "structured" marketing. The basic idea is a hierarchy in which the agent on the lowest level has to share his income with people above him. For example, such an agent may only get a quarter of the earned commission while the rest is distributed to his superiors. This guarantees that the superiors supervise these agents and exercise pressure on their way of providing advice. Since the superiors have no contact of their own with the consumers, the financial interest in the advice is much more biased with them than with an abstract supplier who is only interested in the general return from the sale of insurance contracts.

Table 19: Remuneration of agents in structured sales organisations in Germany

HIERARCHY / AGENT	MIN. UNITS	PROV. OWN TURNOVER	FROM SUB-AGENT
6 / Director A.	48.000	18,22 €	1,72 €
5 / Director A.	18.000	16,50 €	2,50 €
4 / Chief A.	6.500	14,00 €	3,00 €
3 / Main A.	2.500	11,00 €	3,00 €
2 / Leading A.	1.000	8,00 €	3,00 €
1 / Agent	Certification, up to 500	5,00 €	3,00 € Boni. 4,00 €
A / Applicant	Ap	4,00 €	1,00 € Boni. 4,00 €

Source: Internal HMI-Information 2006.

4.1.4 Bancassurance

The enormous presence bancassurance and PPI attracted in the responses provided by stakeholders in this project in all countries may also coincide with similarities between bank employees and MLM agents. The bank employees selling insurance is not directly linked to the insurer since they are employees of a powerful market player in financial services – the bank. These banks are the true and powerful clients of the insurance

¹⁵² Article 2 (2) (g) Directive 2008/48/EC "(g) credit agreements where the credit is granted by an employer to his employees as a secondary activity free of interest or at annual percentage rates of charge lower than those prevailing on the market and which are not offered to the public generally".

companies. Similar to MLMs, they offer to sell a minimum number of units to their clients, especially where the insurance is bundled with credit. Factually they can offer 100.000s of retail insurance contracts for an insurance company with one single relation represented by a framework contract. The actual forms of payment protection insurance mirror this bank influence. They are most visibly adapted to the needs of a bank¹⁵³ to earn as much in commission and interest as possible.¹⁵⁴

Unlike ordinary risk life insurance they are:

- Linked to a credit, which due to refinancing practices will last only for a short time, so that the bank can earn its commission several times within the initially provided period.
- The commission seems to rise sharply with age so that in one case between the age of 40 and 45 a client had to pay four times higher premiums for the same coverage.
- While premiums are usually paid pro rata tempore in PPI they have to be prepaid for up to 12 years. The only reason for this is to provide an opportunity for the bank to finance these premiums.
- The insurance does only cover such risks which originate during the time of its existence, which lowers the actually covered risks so much, that out of millions of contracts only 2000 per year led to payments in Germany.

Similar problems are visible in endowment insurance. The high attraction such cooperation between banks and insurance has for the banks, has replaced competition between insurers and banks with regard to endowment insurance by cooperation. Banks offer credit to customers where the repayment is shifted into a savings process = a capital life insurance ("endowment") - instead of selling a mortgage with annuities that already incorporate amortisation. This system allows earning high commissions from each sale which advances the profit from the mortgage to the first year. It also shifts the money market risks inherent in endowment insurance which normally the insurer has to carry to the consumer. If then, the promised rate of return is so low that the mortgage is not covered at the end, the consumers will remain indebted.

Such forms are therefore especially prone to mis-selling practices. The problem is far from new. It has been described in detail in the expertise this research group delivered to the EU Commission already in 1998. For this project, PPI as well as endowment insurance had been analysed in the UK, France, Netherlands, Belgium and Germany.¹⁵⁵ But although the proposed amendments to the Consumer Credit Directive were incorporated into its 2002 draft, the final version of Directive 2008/48/EC ignored this problem. Since then PPI and

153 In the author's interview with an unnamed insurance representative during the research referred to in the following footnote it was revealed that the insurance companies would have never offered such credit contracts if not forced into it by banks. The bank would not even pay the average premium to the insurance company. The market power of those three or four banks who "buy" the whole section of PPI insurance of his company would be so big that all its conditions to the consumer were according to the wishes of the bank who thus is the driving force for its mis-selling. At the end of a year some insurers have even to participate the banks in residual profit.

154 The following informations have been assembled in an recent empirical research project by iff. See Reifner/Knobloch/Knops Restschuldversicherung (PPI) und Liquiditätssicherung, Norderstedt 2010 pp.20 ff. see also Reifner Die Restschuldversicherung im Ratenkredit, Wertpapier-Mitteilungen WM 2008, 2329-2339 (PPI in instalment credit); *ibid.* Restschuldversicherung: ein verbraucherpolitischer Skandal, Bank und Markt Heft 3 März 2006, p.28-33 (Payment Protection Insurance Fees – A Scandal) and was based on previous studies (see following footnote).

155 Reifner, Harmonisation of Cost Elements of the Annual Percentage Rate of Charge, APR Project No.: AO-2600/97/000169 (in collaboration with Marcus Wüst (Dipl.-Math.), Leo Haidar (Leeds, UK), Carole Bonhomme (Reims, France), Hamburg, 17 March 1998 III. B (PPI) pp.64 ff and C (Endowment insurance) pp.77 ff.

endowment insurance problems dominate the national discussions everywhere, a fact that is also mirrored in the responses to the surveys conducted for this research.¹⁵⁶

4.1.5 "Linked agents"

To find a category, which characterises those agents that work for MLMs we have made use of the experience in another financial service, where the problem of the separation of intermediation from the supply of goods has been treated extensively in history: consumer credit.

In this area, the separation of marketing and supply of credit into two separate entities occurred already in the 1920s when furniture and the first cars were no longer only sold in the form of instalment purchases, but by using "independent loan" from banks that often were created only for this purpose by the sellers.¹⁵⁷ This new form separated the sale of goods from its financing, with the effect that where sellers went bankrupt, the items remained undelivered. Similarly, when the item delivered did not have the required quality, the consumer had "already paid" the price via the bank, so that he was obliged to repay the credit without the right to withhold payments. The problem was gradually solved in all industrialised countries by jurisprudence, which although dispersed on different contracts, put the borrower into the position to oppose his rights from the sales contract also in the credit contract. Already Directive 1967/104/EEC regulated this partition of labour between seller and bank where the seller factually overtook the marketing of the credit for the bank (very similar to the case in which the bank overtakes the marketing for the insurance company in bancassurance). The uniform law in the EU now calls a relation in which the separation is assumed to create dependencies as a "linked agreement" which is based on a "commercial unit" between two seemingly independent actors.¹⁵⁸ Article 3 (n) of Directive 2008/48/EC reads:

(n) linked credit agreement' means a credit agreement where (i) the credit in question serves exclusively to finance an agreement for the supply of specific goods or the provision of a specific service, and (ii) those two agreements form, from an objective point of view, a commercial unit; a commercial unit shall be deemed to exist where the supplier or service provider himself finances the credit for the consumer or, if it is financed by a third party, where the creditor uses the services of the supplier or service provider in connection with the conclusion or preparation of the credit agreement, or where the specific goods or the provision of a specific service are explicitly specified in the credit agreement.

Especially the definition of the "commercial unit" seems to fit well into the pattern of cooperation and dependencies built up in insurance marketing. If advice and insurance are offered in relation to each other, such commercial unit does also appear where legally the marketing is distributed to different channels.

But it may be argued that this concept is tailored to financing and not to the marketing of a financial product. As already mentioned, the seller of the product acts as an intermediary for credit just as retailers who sell insurance may act as an annex product to credit or the sale of spectacles, travel arrangements, cars etc.

However, the concept of linked marketing is also present in credit brokerage. Historically the same idea was applied when credit brokers entered the field of bank loans. Jurisprudence referred to the theory of a "commercial unity" between the brokerage services and the service of the bank. While this concept was present in jurisprudence and

156 See tables in Annex.

157 For the history of the marketing of consumer credit see Reifner, Verbraucherverschuldung, 1989 pp. 103-142; Benöhr, Konsumentenschutz vor 80 Jahren, Zeitschrift für Handelsrecht 1974 pp 14 ff.

158 See CCD (Directive 2008/48/EC, at <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:133:0066:0092:EN:PDF>.

doctrine the legislator found it unnecessary to use it because he assumed that the mere existence of credit brokerage justified treating it as a part of the credit contract. Article 3 (g) Directive 2008/48/EC treated the cost of brokerage including its advice as part of the credit price.¹⁵⁹ Jurisprudence further held that a bank would still be liable for bad information if it had mandated the broker to comply with these duties.

Such a concept would cover especially bancassurance and MLM agents. In our final classification we have therefore inserted this category in order to cover all kind of dependencies which should lead to special regulatory measures to ensure that good advice is possible.

Linked services could be assumed where between different providers of services, which from a consumer perspective finally relate to one product, exists a *commercial unit*. In this case a number of rules could be applied, such as:

- Each partner of a commercial unit is responsible for all arrangements, information duties and advice.
- The *one price doctrine* according to which all cost and payments related to the main service have to be integrated into its price applies.
- In early termination, users of financial services have a right to a proportional reduction of all fees, interest and commissions they had been obliged to pay.

This concept is included in the figure. It shows the types of intermediaries that may exist in a given Member State. The definitions of those concepts that was provided in the questionnaires developed by iff are reproduced below. They provide a compromise between the existing classifications and the concept of dependency as used in this research.

4.1.6 Economic choices and functions of intermediaries

According to the economic theory of the firm, the coexistence of the different organizational choices can be explained by differences in firms' operating or contracting environments which lead them to efficiently make different organizational choices¹⁶⁰. However, there is a controversy in the literature about whether this improves the quality of financial services. According to the product quality hypothesis, independent agents or brokers provide higher service quality than exclusive or tied agents and therefore remain on the market despite their comparatively high costs. In contrast, the market imperfections hypothesis states that the different intermediaries do not differ with respect to the service quality and coexist because of prevailing information asymmetries or a lack of market transparency. Empirical evidence is mixed, but tends to support the product quality hypothesis for consumer insurance markets in Germany.¹⁶¹ Table 20 summarises the main differences between the four main distribution channels.

159 (g) total cost of the credit to the consumer means all the costs, including interest, commissions, taxes and any other kind of fees which the consumer is required to pay in connection with the credit agreement.

160 Regan, L. and Tennyson, S., Insurance Distribution Systems, in: The Handbook of Insurance, Georges Dionne (ed.), 2000, Chapter 24.

161 Trigo Gamarra (2008) finds that in the German life insurance market insurance brokers and financial consultants provide higher service quality than tied agents. Eckardt (2007) finds that the information quality provided by insurance intermediaries who are mainly engaged in personal lines increases with their independence from insurance companies. Eckardt and R athke-D oppner (2010) find that independent agents and insurance brokers provide better service quality measured by information services and contract conclusion rates, but exclusive agents provide more additional services. Trigo Gamarra, L. (2008), Reasons for the Coexistence of Different Distribution Channels: An Empirical Test for the German Insurance Market, The Geneva Papers on Risk and Insurance - Issues and Practice, 33, 389-407; Eckardt, M. (2007), Insurance Intermediation: An Economic Analysis of the Information Services Market, Berlin, Heidelberg:

Table 20: Distribution channels of financial services

	DIRECT WRITING (EMPLOYEE SALES AGENT, CALL CENTRES, INTERNET, ETC.)	EXCLUSIVE AGENT (INCLUDING BANCASSURANCE)	INDEPENDENT (OR MULTIPLE) AGENT (INCLUDING BANCASSURANCE)	BROKER (INCLUDING BANCASSURANCE)
Relationship with supplier	integrated	tied to one producer	independent, agreements with several producers	fully independent
Responsibility	Agent of producer	Agent of producer	Agent of producer (and consumer)	Agent of consumer (and producer)
Sales force remuneration	Fixed salary Performance bonus	Commission Fixed salary (Fee)	Commission (Fee)	Fee
Product complexity/uncertainty of environment	low	low	medium	high
Asymmetric information	low	low	medium	high
Main economic functions	Economies of scale	Economies of scale Facilitating market matching	Economies of scale Facilitating market matching Alleviating asymmetric information problems	Economies of scale Facilitating market matching Alleviating asymmetric information problems
Main activities	Brokerage	Brokerage Ancillary advice to consumers	Brokerage Ancillary advice to consumers Additive advice to consumers	Brokerage Ancillary advice to consumers Additive advice to consumers

The sales force remuneration differs according to the relationship and responsibility of the intermediary to the supplier. Exclusive and independent agents are generally regarded as agents of the companies they represent, while brokers are regarded as agents of their clients. Therefore, the former are usually compensated by commissions and the latter by fees¹⁶². However, exclusive and independent agents may also act on behalf of the client. For example, if a customer seeks general advice from a multiple agent on his or her insurance needs, the agent would carry legal responsibility for negligent advice, and the actions of the agent could not be attributed to any particular insurance company. Likewise, insurance brokers may also act on behalf of insurance companies, for example if they have authority to grant cover or settle claims on their behalf. In these cases, when an intermediary acts for both parties, there is some scope for conflicts of interest. Independent agents are often compensated solely by commissions, while exclusive agents often receive some additional fixed salary. The optimal weighting of commission and fixed salary remuneration reflects a trade-off between providing effort incentives and building long-term relationships or sharing risks. Exclusive agents, who are restricted to offer products only from one provider, often get particularly favourable sales commission, sales support, and relation-specific investments (e.g. marketing seminars, office space), plus a fixed salary.¹⁶³

Physica; Eckardt, M. and R athke-D oppner, S. (2010), The Quality of Insurance Intermediary Services – Empirical Evidence for Germany, *Journal of Risk and Insurance*, 77, 473-497.

162 European Commission, Business insurance sector inquiry, Inquiry into the European business insurance sector pursuant to Article 17 of Regulation 1/2003, Interim report, European Commission, Competition DG Directorate D, Unit D 1 Financial services, 2007.

163 Aschenbrenner von Dahlen, S. and Napel, S., Insurance Intermediation – Theoretical Analysis and Practical Issues in the European Market, *Zeitschrift f ur die gesamte Versicherungswissenschaft*, 93, 2004, p. 73.

When products are complex and the environment is uncertain, independent agents and brokers have an advantage, because they can intervene in conflicts between supplier and consumer and participate in risk assessment. In uncertain environments the greater ability of independent agents to diversify risk across suppliers lowers the compensation they require for risk bearing.¹⁶⁴

Regarding the economic functions and services offered, financial intermediaries have four roles:¹⁶⁵

(1) Economies of scale:

- For consumers: collecting documents, other administrative tasks
- For producers: collecting documents, formalising contracts, other administrative tasks

(2) Facilitate market matching:

- for consumers: searching products, providing price quotations
- for producers: establishing links with clients, distributing products, promoting and advertising products

(3) Alleviate ex ante asymmetric information problems before contract is signed:

- for consumers: advice about suitable products, risks and contract terms, comprehensive consulting
- for producers: risk assessment (to reduce adverse selection)

(4) Alleviate ex post asymmetric information problems (moral hazard) after contract has been signed:

- for consumers: monitoring producers' compliance with contract terms, assistance in filing consumer complaints
- for producers: monitoring customers' post-contractual performance, collecting customers' payments.¹⁶⁶

Their services can be classified into brokerage and advice. Brokerage comprises preparation, execution and follow-up of transactions, and includes assisting suppliers in risk assessment, sales, post-contractual services to customers and suppliers and administration. In the case of standardized products or informed consumers, advice is not necessary. In most cases, however, brokerage goes along with ancillary or additive advice. Ancillary advice provided by intermediaries is inseparably combined with brokerage and serves to reduce the ex-ante information gap between producer and consumer concerning a particular product, by consulting the consumer about product choice, risks and contract design. In contrast, additive advice is broader and may comprise a comprehensive risk, insurance and old-age provision consulting, implying a larger quantity and quality of advice on product choice. Exclusive agents provide only brokerage with ancillary advice, while independent agents and brokers provide brokerage with ancillary and additive

164 Regan, L. and Tennyson, S., Insurance Distribution Systems, in: The Handbook of Insurance, Georges Dionne, editor, Chapter 24, 2000, p.23.

165 DG Internal Market and Services, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H), Contract ETD/2007/IM/H3/118, Final Report by Europe Economics London, 2009, p.29.

166 DG Internal Market and Services, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H), Contract ETD/2007/IM/H3/118, Final Report by Europe Economics London, 2009.

advice.¹⁶⁷ Therefore, the former are mainly matchmakers, while the latter are matchmakers and providers of advice to reduce information asymmetries. Brokers mainly reduce ex-ante asymmetric information problems and play only a minor role in post-contractual relations between consumer and provider.¹⁶⁸ A third category of advice is brokerage-neutral advice, which, however, does not serve to conclude a contract and therefore is usually not a function of insurance intermediaries. In Germany, it may be provided by brokers.¹⁶⁹

4.1.7 Summary

Figure 24: Types of insurance intermediaries

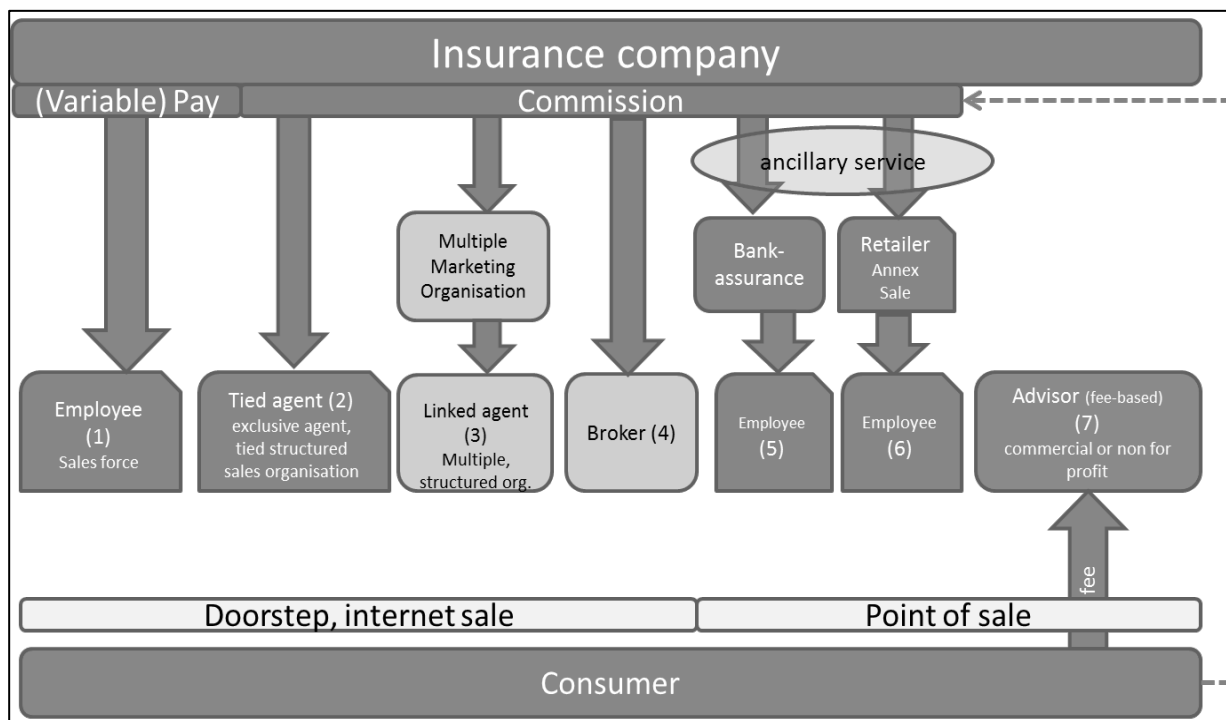


Table 21: Types of intermediaries and terms defined

<p>INTERMEDIARY: PROFESSIONAL WHO FACILITATES THE CONCLUSION OF CONTRACTS BETWEEN FINANCIAL PRODUCT PROVIDERS AND CUSTOMERS. IN CASE OF A CHAIN OF PARTIES BETWEEN THE CUSTOMER AND THE PROVIDER WE CONSIDER INTERMEDIARIES TO BE ONLY THOSE WITH A DIRECT RELATIONSHIP OR INTERACTION WITH THE CUSTOMER.</p> <p>DIRECT WRITER: INSURER WHO SELLS PRODUCTS DIRECTLY (ALSO KNOWN AS CARRIER OR PRODUCER).</p> <p>AGENT: ANYONE CONTRACTED BY A PROVIDER (EXCEPT ITS OWN SALES FORCE) TO ARRANGE OR CONCLUDE CONTRACTS ON A COMMERCIAL BASIS, SUBORDINATED TO PROVIDER COMMANDS.</p>

167 Beenken, M., Brühl, B., Wende, S., Darstellung und Abgrenzung des deutschen Versicherungsvermittlungsmarktes, Zeitschrift für die gesamte Versicherungswissenschaft, 100 (1), 2001a, p.73-88; Höckmayr, G.K., Wandel der Beratungsqualität auf dem Versicherungsvermittlungsmarkt: Eine ökonomische Analyse der Veränderungen aufgrund der Anforderungen der EU-Vermittlerrichtlinie, Zeitschrift für die gesamte Versicherungswissenschaft, 101 (1), 2012, p.75-102.

168 Aschenbrenner von Dahlen, S. and Napel, S., Insurance Intermediation – Theoretical Analysis and Practical Issues in the European Market, Zeitschrift für die gesamte Versicherungswissenschaft, 93, 2004, p. 75. In the case of large commercial insurance customers, brokers also design and place insurance on behalf of the customers and negotiate with insurance companies about coverage design, pricing and placement. Cummins, J. D. and Doherty, N. A., The Economics of Insurance Intermediaries, The Journal of Risk and Insurance, 73, 2006, pp. 361.

169 Beenken, M., Brühl, B., Wende, S., Darstellung und Abgrenzung des deutschen Versicherungsvermittlungsmarktes, Zeitschrift für die gesamte Versicherungswissenschaft, 100(1), 2001a, p.82.

CATEGORIES:

EMPLOYEE: PROVIDER'S OWN STAFF LEGALLY LINKED TO THE SUPPLIER THROUGH AN EMPLOYMENT CONTRACT.

TIED AGENT OR EXCLUSIVE AGENT CAN ONLY PROMOTE THE SERVICE OF ONE PARTICULAR PROVIDER EITHER INDIVIDUALLY OR AS PART OF AN ORGANISATION.

LINKED AGENT: CONNECTED TO MULTIPLE INSURERS OFTEN IN A (STRUCTURED) SALES ORGANIZATION THAT HOLDS FIXED CONTRACTUAL RELATIONSHIPS WITH ONE OR FEW PROVIDERS, OR IS OWNED BY THEM, AND IS ORGANIZED THROUGH MULTIPLE HIERARCHICAL LEVELS.

BROKER WHO WORKS UNTIED AND UNLINKED ON BEHALF OF SEVERAL SUPPLIERS AND/OR CONCLUDES CONTRACTS FOR A CLIENT ON A COMMERCIAL BASIS WITHOUT HAVING BEEN CONTRACTED TO DO SO BY A PROVIDER OR A PROVIDER'S AGENT, OR SALES COMPANY AS A LEGAL ENTITY SEPARATE FROM THE PROVIDER. IF YOU ARE LEGALLY ADMITTED AS A BROKER BUT QUALIFY FOR ANOTHER CATEGORY PLEASE USE ONLY THIS CATEGORY.

BANCASSURANCE: BANK SALES FORCE SELLING PRODUCTS SUPPLIED BY AN INSURER. PARTNERSHIP OR RELATIONSHIP BETWEEN A BANK, ACTING AS AGENT OR BROKER, AND A THIRD FINANCIAL SERVICES PROVIDER WHEREBY THE BANK'S SALES CHANNEL IS USED TO SELL PRODUCTS OF AN INSURANCE COMPANY.

RETAILER: SALE OF AN ANCILLARY PRODUCT OR SERVICE, OFTEN BY RETAIL FIRMS LIKE CAR DEALERS, ACTING MOSTLY AS TIED AGENT.

FEE BASED ADVISER: ANYONE ADVISING THIRD PARTIES IN RESPECT OF AGREEING, AMENDING OR EXAMINING FINANCIAL SERVICES' CONTRACTS OR REPRESENTING THE CLIENT OUT OF COURT VIS-À-VIS THE FINANCIAL SERVICES PROVIDER WITHOUT RECEIVING AN ECONOMIC BENEFIT FROM THE PROVIDER.

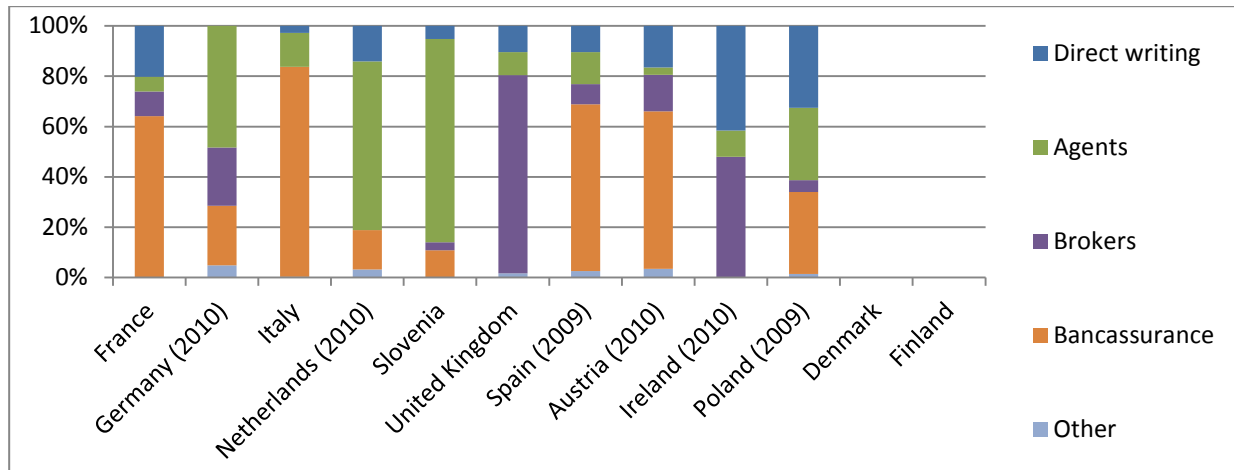
4.2 Distribution channels

4.2.1 Life insurance

Life insurance plays not only a large role for consumers, but also for intermediaries that earn their income mainly from commissions. More than 86% of the life insurance in Europe is sold through intermediaries, with large variations of the types of intermediaries used. Figure 7 shows the market shares of the different channels through which the new life insurance premiums are distributed in 10 of the 12 member states, based on statistics of Insurance Europe. To facilitate country comparisons and to take into account the availability of data, the following classification has been used: (1) direct writing: employees and distant selling (call centres (telesales), the internet, mailing, etc.), (2) agents: intermediaries who represent the interests of the insurer (tied and multi-tied agents) (3) brokers: intermediaries who represent the interests of the insured, (4) bancassurance: provision of insurance products by banks or lending institutions, which may act as an insurance agent, bank employee or insurance broker, (5) Other. For some countries, categories have been merged with others due to a lack of detail, and for some countries, data refers to the whole business in force (and not the new business). Such cases are indicated in footnotes.¹⁷⁰

170 Insurance Europe (2013b): The European Life Insurance Market in 2011. CEA Statistics No. 47, 2013.

Figure 25: Breakdown of life insurance premiums by distribution channel – 2011 (2010, 2009)



Notes: For Germany, figures cover both individual and group contracts. For Italy, "Other" includes "Distance selling" and "Brokers". For the Netherlands, there are no distinction between agents and brokers. For Slovenia, Spain, Austria, Ireland and Poland data refers to the whole business in force (and not the new business). For the UK, no distinction between agents and employees are made. Bancassurance is distributed among all other categories. The percentage of group business sold through bancassurance in 2009 was 1.3%.

Source: Insurance Europe (2013b): The European Life Insurance Market in 2011. CEA Statistics No. 47, 2013; Insurance Europe (2013a): European Insurance in Figures 2013. CEA Statistics No. 46; own composition.

Figure 7 shows that the direct writing channel is used in all countries except Germany. At the other extreme, 41.6% of the insurance premiums result from contract conclusions through direct writing in Ireland. A breakdown between employee and distance selling is only available for France and the UK, where market shares of distance selling are 3.2%, respectively 10.4%. Older statistics report that in most countries direct selling takes place through own employees. In 2006, distance selling reached market shares above 5% only in Ireland (21%), the Netherlands (11%) and the UK (7%). The high market share of distance selling in Ireland can be related to the high proportion of life insurance business that is written abroad.¹⁷¹ The minor role of distance selling in most countries reflects the fact that life insurance is a product with high information asymmetry and therefore customers' need for advice. Although the use of the internet (via PC and mobile) is expected to grow in the future, face-to-face distribution will still account for 72% of distribution in the next five years.¹⁷²

In addition, the role of the different intermediaries varies significantly between countries. While bancassurance dominates in Italy (83.6%), Spain (66.2%), France (64.2%) and Austria (62.6%), it plays no role in the United Kingdom and Ireland, where instead, 78.8% and 48% of the life insurance premiums are collected by brokers respectively. The strong presence of brokers in Ireland may also be explained by the high share of life insurance concluded abroad. Insurance agents dominate in Slovenia (80.8%), the Netherlands (67.1%) and Germany (48.8%). Regarding the comparatively large role of life insurance in the UK and France as shown, these results indicate that the different role of distribution channels in these countries does not seem to matter for the successful sale of life insurance products.

Recent comparable data for Denmark and Finland are missing. In Finland, bancassurance ranked first with a market share of at least 56%, followed by direct selling (30%), while

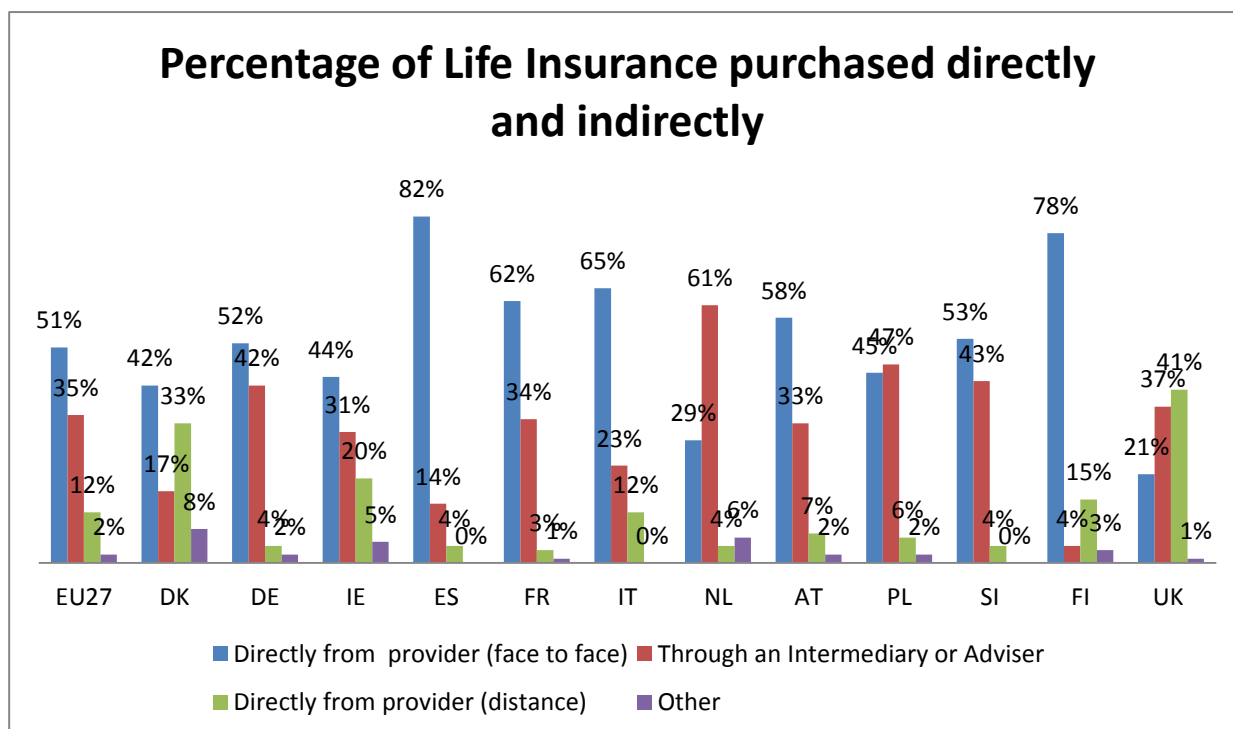
171 Insurance Distribution Channels in Europe, CEA Statistics No. 39, March 2010, p.13.

172 Based on a customer survey in 41 countries in 2012. Capgemini, World Insurance Report 2013, p.32.

brokers played only a minor role (3.7%) in 2006. In Denmark, direct selling dominated, followed by bancassurance, while brokers were used only by large customers in 2006.¹⁷³ According to a recent report, tied agents are used in individual pensions, while brokers are only active in the business-to-business market.¹⁷⁴

Figure 26 shows the results of the 2011 Eurobarometer survey of consumers concerning distribution channels of life insurance. In contrast to Figure 25, it shows that direct writing face-to-face is the most widely used distribution channel in all countries except the Netherlands and the UK. Distance selling plays only a minor role (6% in EU27 average). Distribution through an insurance intermediary or advisor has a market share of 35% in the EU27 and ranges from 14% in Spain to 61% in the Netherlands.

Figure 26: Life insurance purchased - from insurer or from an intermediary



Source: European Commission, Special Eurobarometer 373, Retail Financial Services, 2012, p.49, own composition.

4.2.2 Non-life insurance

Non-life insurance products are mainly distributed through agents and brokers, with agents generally playing a bigger role than brokers (see Figure 27). Agents dominate in Italy, Germany, Slovenia and Poland, while brokers are prevalent in Ireland and the UK. Direct selling through employees and distance selling is the main distribution channel in the Netherlands with a market share of 34% in 2010, but also popular in Ireland (41%), Austria (35%) and France (35%). Bancassurance plays only a minor role. Data for Denmark and Finland are again missing. In Finland, distribution through own employees and tied agents played a large role in non-life insurance, while brokers reached a market

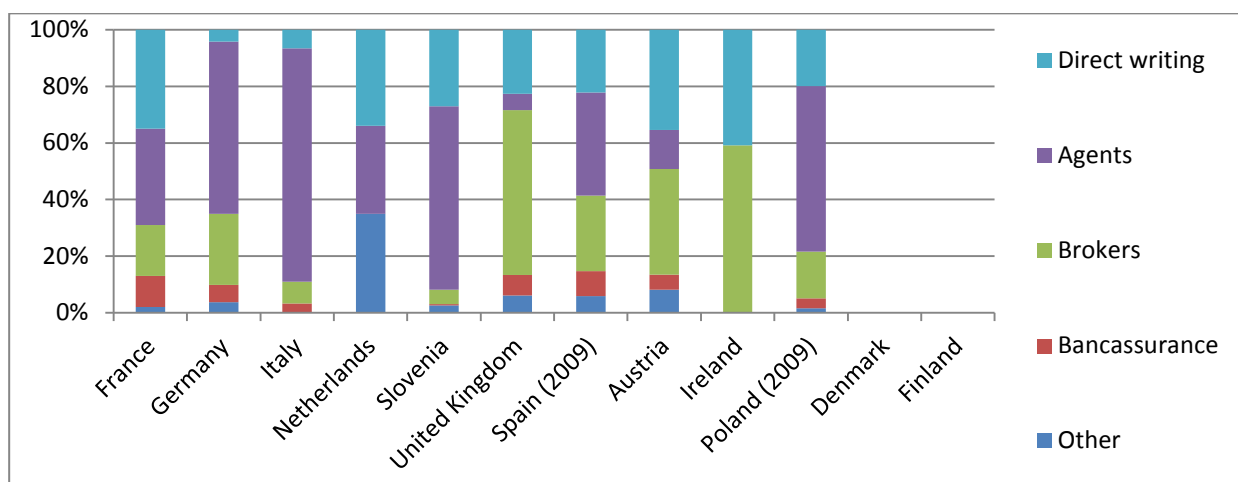
173 Insurance Distribution Channels in Europe, CEA Statistics No. 39, March 2010, Annex 2.

174 Forsikring&pension, Insurance mediation: Benefitting from the potential of Danish experiences, 19.03.2013, <http://www.sven-giegold.de/wp-content/uploads/2013/03/Danish-Insurers-MEP-Seminar-20th-of-march.pdf> (viewed 8.07.2013)

share of only 4.7% in 2006.¹⁷⁵ A recent study for Denmark reports that private non-life insurance products are mainly distributed through tied agents.¹⁷⁶

Figure 28 compares the distribution channels in life and non-life insurance markets for the year 2010. It shows that direct selling plays a larger role in the distribution of non-life insurance products, which can be explained by the fact that searching products (market matching) and alleviating asymmetric information problems by intermediaries is less important in these markets. A breakdown between employee and distance selling is not available. A customer survey in 41 countries in 2012 finds that, especially in simpler personal non-life insurance lines, distance selling through call centres or the internet has increased and reached around the same market share as agents (about 22%). However, agents and brokers will still dominate complex products, especially commercial lines.¹⁷⁷

Figure 27: Breakdown of non-life insurance premiums by distribution channel – 2010



175 Insurance Distribution Channels in Europe, CEA Statistics No. 39, March 2010, Annex 2.

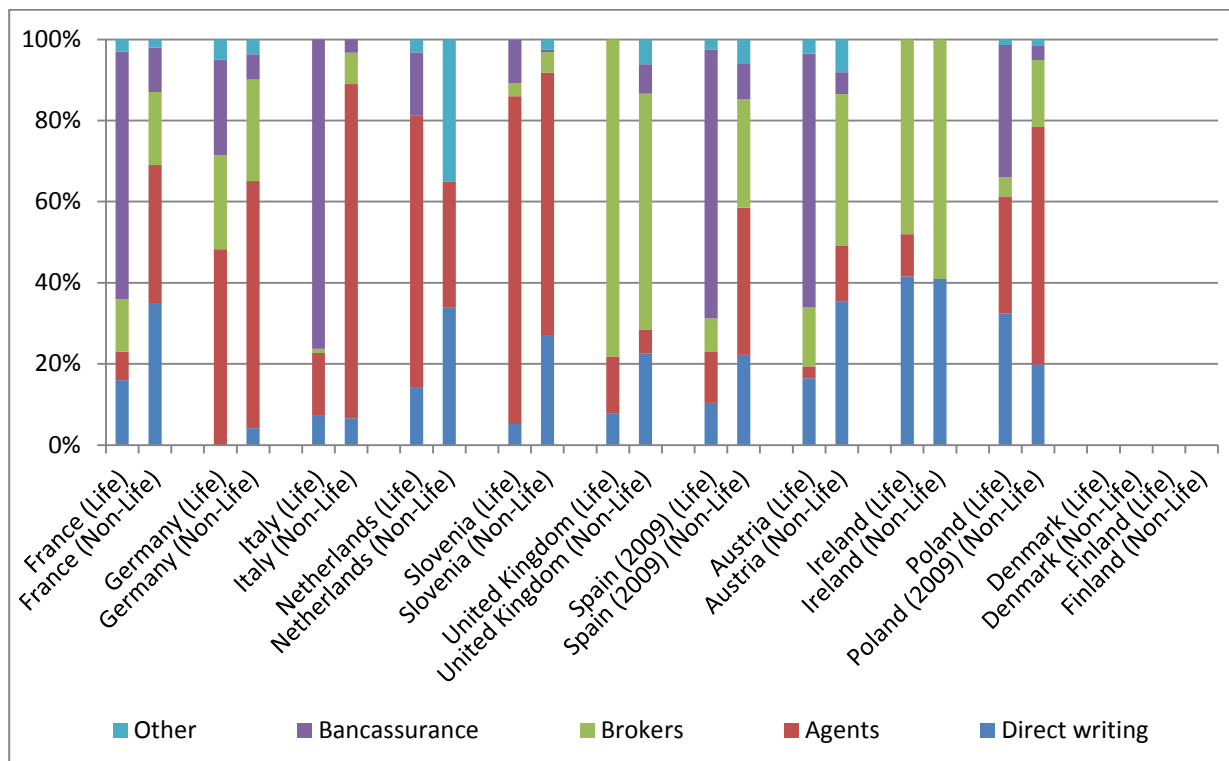
176 Forsikring&pension, Insurance mediation: Benefitting from the potential of Danish experiences, 19.03.2013, <http://www.sven-giegold.de/wp-content/uploads/2013/03/Danish-Insurers-MEP-Seminar-20th-of-march.pdf> (viewed 8.07.2013)

177 Capgemini, World Insurance Report 2013, p.32.

Notes: For the Netherlands, agents are included with brokers.

Source: Insurance Europe (2013a): European Insurance in Figures 2013. CEA Statistics No. 46, p.64.

Figure 28: Breakdown of life and non-life insurance premiums by distribution channel - 2010



Notes: Data for Germany and the UK refers to new business only. For the UK, bancassurance is included in all other channels. For the Netherlands, agents are included with brokers.

Source: Insurance Europe (2013a): European Insurance in Figures 2013. CEA Statistics No. 46, p.63-64, own composition.

An analysis of three non-life retail insurance markets (third-party liability motor insurance, comprehensive motor insurance and home/household insurance) in the EU27 finds that direct selling through the telephone or the internet has increased over the last decade, while sales through tied agents have declined nearly everywhere.¹⁷⁸ For most of the EU27 member states, the 5-firm concentration ratio clearly declines with the number of insurance firms in the market. As in life insurance markets, Germany has the least concentrated non-life retail insurance market in Europe, while Slovenia is at the top. Market concentration measured by the Herfindahl-Hirschman Index¹⁷⁹ is highest in Poland and Slovenia, but also high in the Scandinavian countries.¹⁸⁰ Another measure of the intensity of competition is the rate with which policyholders switch providers. Switching rates vary significantly across Europe and range from less than 10% in Italy to perhaps above 30% in the UK and tend to be higher in motor insurance than in home insurance.¹⁸¹

178 Europe Economics, Retail Insurance Market Study, Markt/2008/18/H, London, 2009, p.x.

179 The Herfindahl-Hirschman Index, measured by the sum of the market shares of the largest firms, gives greater weight to the largest firms.

180 Europe Economics, Retail Insurance Market Study, Markt/2008/18/H, London, 2009, p.ii.

181 Europe Economics, Retail Insurance Market Study, Markt/2008/18/H, London, 2009, p.xii..

4.2.3 Credit

Residential mortgages

In the EU27 average, nearly 42% of the residential mortgage credits were sold through intermediaries in 2007. However, this figure was heavily influenced by the high penetration in the UK market (which size declined significantly in 2008). In our sample of 12 member states, the share of intermediaries in the distribution of residential mortgages ranges from 1% in Finland to 70% in the UK (see Table 22). This can partly be explained by the degree of competition in the banking market. With rising concentration of banking markets the extent of market penetration by intermediaries declines, because the value of their search function is reduced. This explanation has some force at least in some of the Scandinavian countries such as Finland. On the other hand, increased price competition in tight markets has induced banks to cut down distribution costs by using more independent intermediaries, as observed in Germany.¹⁸² Another explanation for the high market penetration by mortgage intermediaries, in particular in the UK, the Netherlands and Ireland, is the high degree of regulation of these intermediaries.¹⁸³

Also the share of tied and untied intermediaries varies across countries. As in the case of life insurance markets, brokers dominate in Ireland and the UK, while tied or multi-tied agents have a larger market share than brokers in Italy and Spain. In Germany, tied and untied agents seem to play a smaller role in residential mortgage markets than in life insurance markets. However, conclusions are less robust because of limited data for Germany (Table 22).

Table 22: The residential mortgage intermediary market in selected member states 2007

	INTERMEDIARY SHARE	DOMINANT TYPE OF INTERMEDIARY
Finland	1.0%	tied or multi-tied agents
Denmark	5.0%	
Slovenia	15.0%	
Spain	20.0%	tied or multi-tied agents
France	22.5%	Brokers or advisors
Poland	24.0%	
Italy	25.0%	tied or multi-tied agents
Germany	32.5%	ca. 50% tied, 50% untied
Austria	35.0%	Brokers or advisors
Netherlands	45.0%	
Ireland	60.0%	Brokers or advisors
United Kingdom	70.0%	Brokers or advisors

Note: The data for Germany is limited and so conclusion is less robust. Data for the remaining countries in our sample of 12 member states are not available.

Source: Europe Economics, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H) Contract ETD/2007/IM/H3/118 Final Report 15 January 2009, p. 97; own composition.

Personal loans

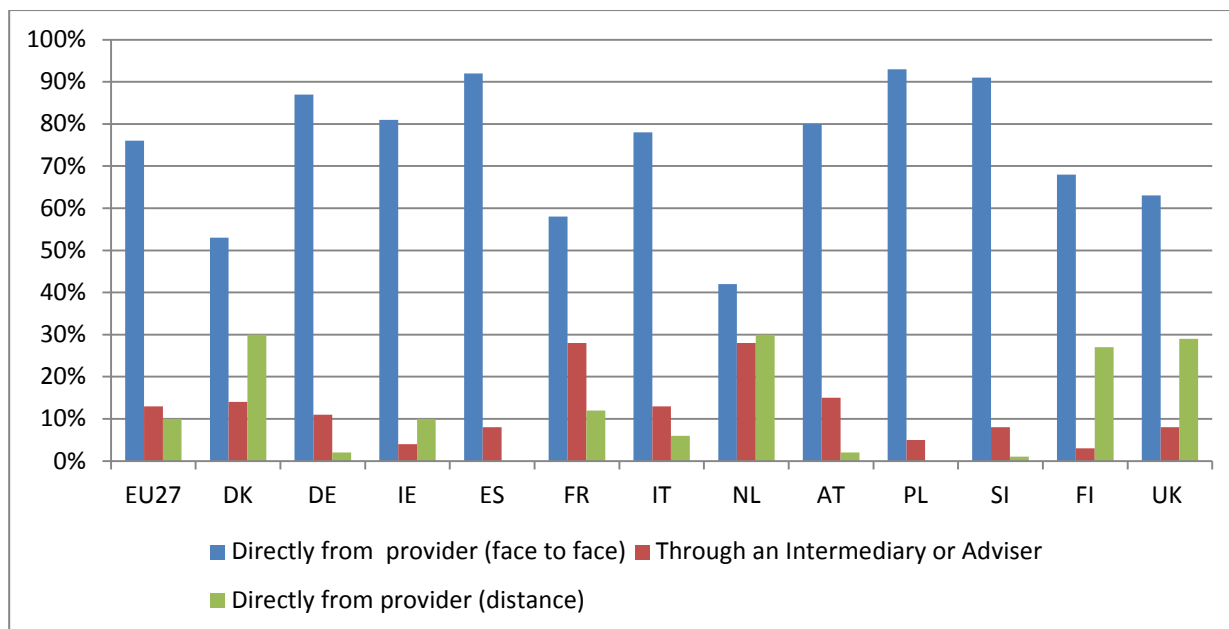
Figure 29 shows the distribution channels of personal loans based on the Eurobarometer consumer survey 2011. In all countries except the Netherlands, the majority of consumers buy personal loans directly from the provider. In the Netherlands, only 42% do so, while

¹⁸² Europe Economics, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H) Contract ETD/2007/IM/H3/118 Final Report 15 January 2009, p.99-101.

¹⁸³ Europe Economics, Study on Credit Intermediaries in the Internal Market (MARKT/2007/14/H) Contract ETD/2007/IM/H3/118 Final Report 15 January 2009, p.123.

30% buy online instead. Only 13% of personal loans in the EU27 are sold via a credit intermediary or advisor. In our sample of 12 member states, this share ranges from 6% in Poland to 28% in France and the Netherlands.¹⁸⁴

Figure 29: Distribution channels of personal loans (2011)



Source: European Commission, Special Eurobarometer 373, Retail Financial Services, 2012, p.47, own composition.

4.2.4 Investments

Table 23 shows the distribution channels that are used in certain of the selected Member States. There are basically two types of distribution channels for mutual funds, direct and indirect. Direct refers to the investor buying units directly from the fund Asset Management Company (AMC), whereas indirect channels include the involvement of agents who act as intermediaries between the fund and the investor (assisting investors in buying and redeeming fund units but also providing advisory services). The 3 main financial intermediary types in the area of retail investments are: Independent financial advisers (IFA, usually individuals trained by AMCs for selling their products, but some are certified financial planners), organised distributors (with the infrastructure and resources for managing administration of the fund) and the banks (who use their network and existing customer base, and offer wealth management). Retail banking is the predominant sales channel for investments; however large national differences exist as to the share of distribution carried out by financial advisers on institutional players serving retail consumers such as platforms and fund supermarkets.

Table 23: Distribution channels for investments

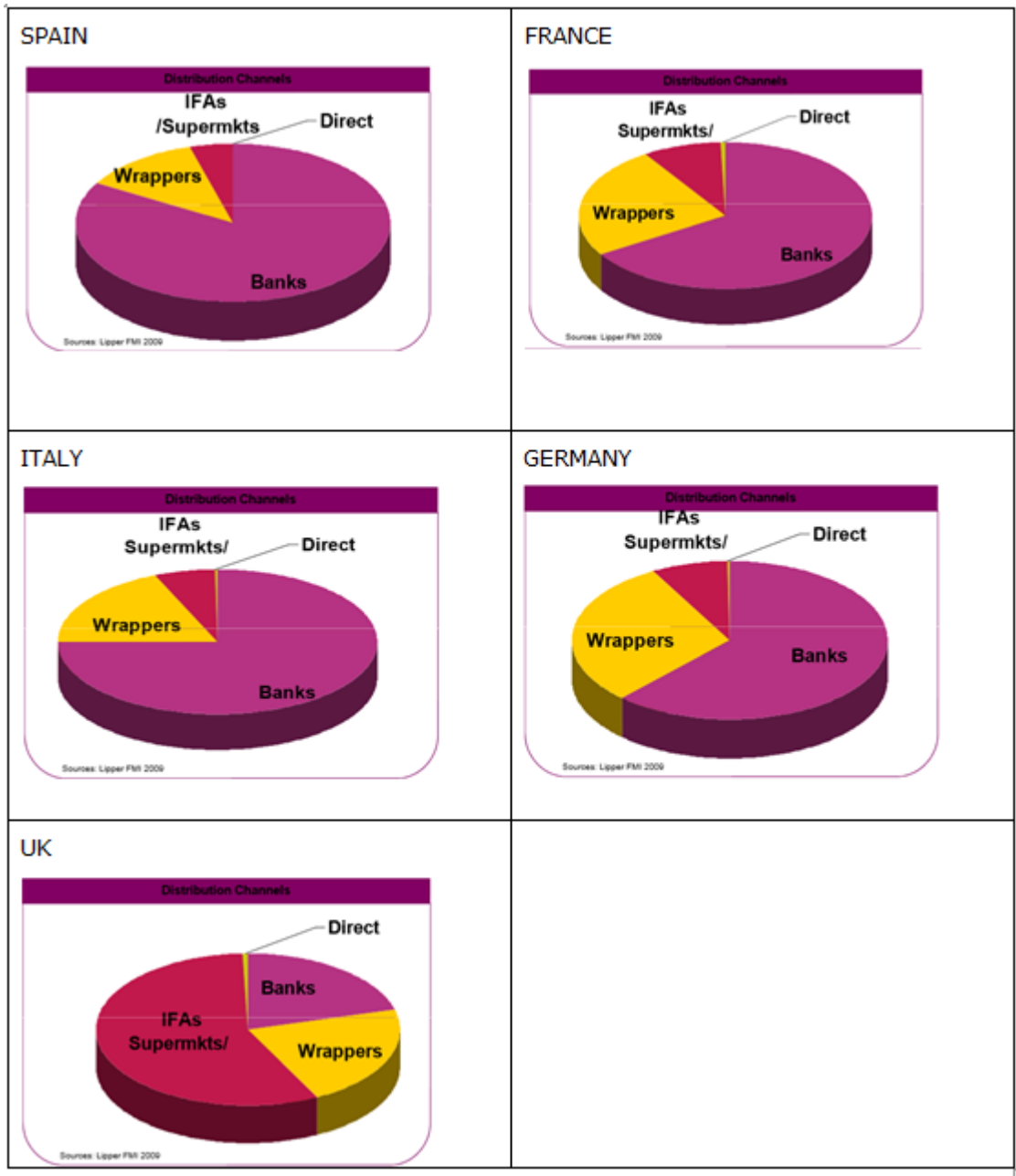
	UK	FR	ES	DE	IT
Retail Bank	2%	21%	63%	44%	54%
Private banking	6%	11%	8%	14%	13%
Insurance/Pension	12%	14%	5%	16%	14%

184 European Commission, Special Eurobarometer 373, Retail Financial Services, 2012, p.47.

	UK	FR	ES	DE	IT
IFA	56%	8%	4%	7%	6%
Fund Platform / Supermarket	2%	0%	0%	1%	0%
Institutional/corporates	13%	34%	12%	4%	8%
Direct	1%	1%	0%	0%	0%
Fund of Funds	9%	11%	7%	14%	5%

Source: Cross-border distribution of UCITS (Caeis, 2011), Cerulli.

Figure 30: Investments, share by distribution channels for 5 Member state



Source: Lipper

4.2.5 Housing and labour

Labour markets

Intermediation in the labour market has, from its beginning, been exercised by collective effort and since the beginning of the 20th century by public institutions that still dominate the intermediation for job seekers in most states.¹⁸⁵ Although in the last two decades there have been efforts for privatisations¹⁸⁶, private intermediation in these markets remain highly regulated.¹⁸⁷ Not only contents but also methods of advice are regulated.¹⁸⁸ The law even provides that the intermediation is in principle free charge for both sides of the envisaged labour contract.¹⁸⁹

Housing markets

Much legal experience exists with the effects of volume based brokerage fees in the real estate market. Here, the dependency of brokers does not concern the supplier of a rentable flat, a house for sale or a mortgage loan. Remuneration systems themselves create an odd incentive for higher volumes where fees are based onto it. While the client would seek an optimal relation between quality of the home and price (house price or rent), the broker would be incentivised only to go for the highest price. Brokers may without dependencies to the suppliers of the home increase the rent or the price for them to the detriment of the consumer or tenant. This conflict of interest has led to numerous historical restrictions with regard to brokerage fees, reaching from a total ban in price regulated house markets to caps for brokers' fees or even the creation of state agencies which replace market driven private intermediation.¹⁹⁰

185 Austria: Arbeitsmarktservice; Denmark: Jobbutiken; France: Agence national pour l'emploi; Germany: Bundesagentur für Arbeit; Italy: Centro per l'Impiego and Centro di Iniziativa Locale per l'Occupazione; Netherlands: Uitvoeringsinstituut Werknemers Verzekeringen; Sweden: Arbetsförmedlingen; UK: Job centres; Ireland: Training and Employment Authority.

186 P Craig, M Freedland, C Jacqueson and N Kountouris, *Public Employment Services and European Law* (2007); International Labour Office, *The role of private employment agencies in the functioning of labour markets* (Report VI 1994) International Labour Conference 81st Session; Oliver Bruttel, *Die Privatisierung der öffentlichen Arbeitsvermittlung: Australien, Niederlande und Großbritannien. Ein Vergleich aus neo-institutionenökonomischer Perspektive*, Baden-Baden: Nomos 2005.

187 For Germany see the consecutive regulations of labour intermediation in Gesetz über Arbeitsvermittlung und Arbeitslosenversicherung 1927; Arbeitsvermittlungsgesetz 1969 and Sozialgesetzbuch III (promotion of labour Arbeitsförderung) 1997/2011 sections 35 ff.

188 § 35 Offer of Intermediation shows similarities to MiFID with regard to the intermediation like: the agency has to do all possible that a job seeking persons gets a suitable workplace It has to take into consideration the inclination, ability and capacity of the person as well as the requirements of the offered workplace which corresponds to Article he current MiFID appropriateness requirements are set out in Articles 19(5) and (6) of MiFID (2004/39/EC) and in Articles 36-38 of the MiFID Implementing Directive (2006/73/EC). MiFID requiring subjective and objective inquiries into the suitability of a product with regard to the wishes and abilities of a consumer.

189 See Section 42 Principle of honourosity SGB III (Germany).

190 See the capo f two monthly rent payments for the brokerage fee in Article 3 (2) Gesetz zur Regelung der Wohnungsvermittlung (WoVermG) v. 04.11.1971 BGBl. I S. 1745, 1747 (Law on the intermediation of dwellings) Article 2 also excludes a commission if the broker is somehow identical or linked to the provider of the dwelling. For France, see JORF n°0024 du 28 janvier 2012 page 1649 texte n° 15 Décret n° 2012-101 du 26 janvier 2012 relatif aux intermédiaires en opérations de banque et en services de paiements.

5 Regulation: What are the solutions?

In this part, we will show that Regulation can take various forms and that there is no one model that prevails across the member states studied. Legislation and case law tend to be primary sources, but codes of practice in the form of principles for businesses are also in use. Overall, it is a patchwork of regulation that applies in all member states included in this study. This is true when looking at the entire sample as well as within it. In each country the regulation of conflicts of interests tends to be vertical and specialised rules. Similarly, our study shows that key notions such as ‘remuneration’ and ‘intermediaries’ are not uniform. Licensing regimes are also varied. This part also reviews restrictions imposed by regulation on remuneration (including employee remuneration, forfeiture, caps on commissions and duration). It looks into some detail at bans on certain forms of remuneration that have been imposed by some member states as well as the effect such bans are having on the market and stakeholders. Data on transparency and information is also included along with details on early cancellations and legal issues relating to it. Finally, this part concludes looking at enforcement and self-regulation.

Rationale underlying remuneration regulation

The legislation applicable in the Member States surveyed shared some common goals.¹⁹¹

Respondents mentioned consumer protection as an underlying driver in the regulation in a number of Member States, including **Slovenia** and **Poland**. For example in the **UK**, *‘the purposes of ICOBS and the Principles for businesses are to achieve fair outcomes for consumers and thus advance the regulator’s consumer protection statutory objective.’* To do so, the chosen regulatory technique appears to be ‘information’. The provisions require disclosure of commission in respect of consumer sales of insurance products associated with investment advice (ICOBS 4.6 and COBS 6.4.3). In **Spain**, the respondent expressed the legal purpose underlying remuneration regulation as: *‘protection of clients by means of providing a clear and not misleading information about intermediary’s remuneration’.*

In **Denmark**, legislation was adopted to protect consumers as well as promoting confidence. For example remuneration for financial advisers (other than insurance, investment and non-investment) aims to close a gap in legislation and ensure that the market for independent financial advice becomes more transparent, coherent and brought under supervision of the Danish Regulatory body. For non-investment firms, the Executive Order on Good Business Practice’s purpose is to promote fairness and confidence and thereby an efficient market. The Insurance Intermediation Act was introduced to make the cost of insurance products transparent and introduce a ban.¹⁹²

Patchwork of legislation

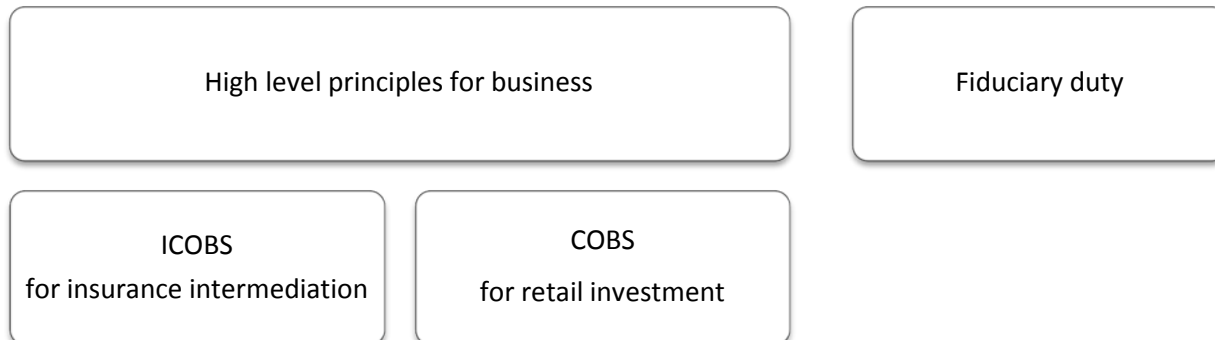
The regulation of remuneration and conflicts of interests has multiple sources, all depending on national preferences. A number of those sources, for example, stem from traditional contract and tort laws and are applicable to financial intermediary in the same

¹⁹¹ Another purpose concerns clarity for the intermediaries, as was the case for Finland.

¹⁹² Andreas Friberg and Magnus Listermar (In association with Ernst & Young Advisory Services), The future of life insurance intermediaries, available online: [http://www.ey.com/Publication/vwLUAssets/The_future_of_life_insurance_intermediaries_EY/\\$FILE/The%20future%20of%20life%20insurance%20intermediaries%20E&Y%20-%20Friberg%20&%20Listermar.pdf](http://www.ey.com/Publication/vwLUAssets/The_future_of_life_insurance_intermediaries_EY/$FILE/The%20future%20of%20life%20insurance%20intermediaries%20E&Y%20-%20Friberg%20&%20Listermar.pdf).

way that they are applicable to all other types of intermediaries.¹⁹³ More specific legislation also tends to exist alongside more traditional forms of regulation through civil law.

In the **UK** for example, the rules governing remuneration and conflicts of interests have different origins. They can be located in a number of sources, some applying horizontally, while others are sectorial. Most are found in the Financial Conduct Authority Handbook.¹⁹⁴



Fiduciary duties in the UK apply to all types of intermediaries. They derive from common law. They principally concern duties of loyalty to the customer and prudence in the conduct of business. Currently, the Law Commission is consulting on the fiduciary duties of investment intermediaries and exploring how fiduciary duties need to be interpreted in the context of investments.¹⁹⁵ The Kay review set out the principle of a fiduciary duty in the following terms: *'Fiduciary standards require that the client's interests are put first, that conflict of interest should be avoided, and that the direct and indirect costs of services provided should be reasonable and disclosed. These standards should not require, nor even permit, the agent to depart from generally prevailing standards of decent behaviour. Contractual terms should not claim to override these standards.'*¹⁹⁶ There are discrepancies between the fiduciary standards and the high level principles of business contained in the Financial Conduct Authority handbook (which replace the FSA's handbook from April 1, 2013).¹⁹⁷ Those principles apply to all authorised financial services providers including insurance intermediaries. Under those principles, *'a firm must conduct its business with due skill, care and diligence'*¹⁹⁸, *'pay due regard to the interests of its customers and treat*

193 See for example Denmark, Ireland, Poland and France. In Denmark, the Consolidated Act no. 781 of 26 August 1996 on Contracts and other legal transactions in property law (the Contract Law) (Lovbekendtgørelse nr. 781 af 26. august 1996 om aftaler og andre retshandler på formuerettens område (aftaleloven)). The most relevant articles are found in the Contract Law chapter II about authority and chapter III about invalidity (namely art. 33 about agreements contrary to good faith and art. 36 about unreasonably contracts). Similarly, the Irish respondent reported that in general the law in relation to remuneration and conflicts of interests is defined by the contractual agreements between the parties, in the context of the common law interpretation by the Courts. In France, obligations now contained in the Code des Assurances (obligation de mise en garde) stem from the application of the principle of civil liability (article 1382). In Poland, articles 758(1) and 761-761(7) of the Civil Code apply to the control of remuneration.

194 <http://www.fshandbook.info/FS/html/FCA>.

195 Law Commission, project on Fiduciary duties of investment intermediaries. For more details, see: http://lawcommission.justice.gov.uk/areas/fiduciary_duties.htm.

196 John Kay, The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report (July 2012), p.65. Available online: <http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf>.

197 For a list of those principles, see: <http://www.fshandbook.info/FS/html/FCA/PRIN/2/1>.

198 Principle 2.

*them fairly*¹⁹⁹ and *'manage conflicts of interests fairly'*²⁰⁰. However, as Kay commented, those principles fall materially below the standards necessary to establish trust and confidence and differ from the standards implied by fiduciary duties of loyalty to a customer.²⁰¹

The legitimacy of the High level principles for business was challenged in ***R (on the application of the British Bankers Association) v Financial Services Authority and another***.²⁰² The British Bankers Association challenged the regulatory response by the FSA to PPI mis-selling practices on the basis that the principles are not source of binding obligations and not actionable in law. Ouseley J. disagreed and clearly identified the principles as the *'overarching framework for regulation'*²⁰³ and *'are best understood as the ever present substrata to which the specific rules are added. The Principles always have to be complied with. The specific rules do not supplant them and cannot be used to contradict them'*.²⁰⁴

Across **other Member States** included in this study, the legislative responses to the regulation of remuneration seem to be heterogeneous in their form and complex in their architecture.

Nevertheless, most follow the MiFID/IMD divide. In **Spain** for example, investment services firms and investment intermediaries are governed by two different pieces of legislation, both administered by two separate regulating entities. For investment services firms, the Securities Markets Act 24/1988 was amended and brought in line with the MiFID Directives. For insurance intermediaries, Act 26/2006 on private insurance and reinsurance mediation implements the IMD. In **Italy**, legislative sources for conflicts of interests are contained in no less than 4 pieces of legislation, including the code of private insurance as well as legislative decrees, specialised laws and regulations. In **Poland**, the following relevant sources apply: the principles of good insurance practices issued by the Polish Insurance Association, the Insurance Activity Act of 2003, the Civil code, the Financial Instrument Trading Act of 2005, the Regulation of the Minister of finance from 2009 on the definition of detailed and organisational conditions of investment companies, the Act on the protection of certain consumers' rights and liability on damage caused by dangerous products of 2012 and the insurance intermediation Act 2003. This complexity is not unique. A multiplicity of sources was also identified in **France, Slovenia and Finland**.

5.1 Key notions in insurance legislation

5.1.1 Remuneration types

The law in member states defines certain types of remuneration, mostly revolving around remuneration from the provider to the intermediary (commissions for example) and remuneration from the consumer to the intermediary (fees for example).

199 Principle 6.

200 Principle 8.

201 John Kay, The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report (July 2012), p.67 at 9.13 and 9.14. Available online: <http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf>.

202 Queen's Bench Division, Administrative Court (London), 20 April 2011; 2011 EWHC 999 (Admin).

203 Ouseley J. at 161.

204 Ouseley J. at 162.

Distinctions drawn in legislation

In the **UK**, **Slovenia** and **Spain**, some legislation draws distinctions between remuneration types. The distinction seems to be satisfactory in the **UK**, but such distinction was not necessarily well-defined or even applicable to insurance intermediaries in other Member states. Indeed, while in **Spain** the law regarding financial investment firms distinguishes between commissions, fees received from clients and non-monetary benefits, legislation on insurance intermediaries does not make such distinction. The relevant legislation does not contain any specific reference to remuneration, except concerning insurance brokers who can accept remuneration in the form of commission on premiums exclusively or in addition to a fee if expressly agreed with the client. In **Slovenia**, the legislation only explains that a broker can be remunerated by way of commission or any other form of payment. As a result, although it is not spelt out, the legislation makes a distinction.

Absence of distinction in legislation

In **Ireland**, *'the law does not specifically distinguish between different remuneration types'* although the respondent noted that the distinction occurred in practice *'as different types of intermediary are remunerated in different ways'*. The distinctions were reported as minimal in **Denmark** and non-existent in **France**, **Finland** and **Italy**.²⁰⁵ In **Poland**, the law does not make any distinctions and the Civil Code seems to be the only source of definition. Article 758 para 1 and 2 explains that when a contract does not specify the manner of remuneration, the agent is entitled to a commission which depend on the number of value of the contracts (sale or contingent commissions).

5.1.1.1 Definition of Commission

A variety of definitions of the notion of commission exist.²⁰⁶ It seems that commissions have the following main characteristics, although there are variations: it can include more than just financial rewards, it is paid to the intermediary by the provider of insurance or other financial service.

For example, in the **UK**, according to the FCA handbook Glossary, a commission is *'any form of commission or remuneration, including a benefit of any kind, offered or given in connection with: (a) designated investment business (other than commission equivalent), (b) insurance mediation activity in connection with a non-investment insurance contract, or (c) the sale of a packaged product, that is offered or given by the product provider.'*²⁰⁷

In **Ireland**, a commission payment, for the purpose of IA 1989, is a payment, including a commission or other remuneration, reward or benefit in kind, paid or payable by or on behalf of the holder of an authorisation to an insurance intermediary in connection with the insurance business of the holder and includes the time allowed by the holder to the intermediary for the payment by the intermediary to the holder of premiums received by the intermediary for the holder for contracts of insurance entered into by the holder.²⁰⁸

205 In Italy, while no distinction is made, Reg IVASS n. 5/2006 and answer to the FAQ do explain that the concept of remuneration is broad.

206 Note that we did not locate one in Italy.

207 FCA handbook Glossary, July 2013, <http://media.fshandbook.info/content/FCA/Glossary.pdf>.

208 <https://www.centralbank.ie/pages/glossary.aspx>.

5.1.1.2 Other forms of remuneration

The term 'fee' is not very usual in the member states that were surveyed. It seemed more usual to refer to remuneration. Similarly, little seems to exist regarding the term 'brokerage', although it is used in some countries.²⁰⁹ As for premiums, net and gross, it was also difficult to locate any definitions in law.

5.1.2 Definitions of types of intermediaries

Countries tend to define persons or activities when dealing with types of intermediaries, but overall most definitions are mixed, leading to some confusion.

5.1.2.1 Mixed definition of 'intermediaries' in national legislation

Definitions based on persons

A number of countries, including **Finland** do have legislation defining intermediary types. In **Italy**, there is a rigid distinction between intermediaries made in the Code of Private insurances. In **Poland** also, the law differentiates between intermediaries working on behalf of the provider and those working on behalf and/or for of the client. **Irish** law also defines types of intermediaries but as the respondent notes, *'the legislation is very confused due to multiple amendments and no consolidated versions'*.

The **Spanish** law does provide for categories of intermediaries for investment services firms as well as insurance intermediaries. Article 7 of the 26/2006 Act does lay out the following intermediaries:

- Exclusive agents
- Tied agents
- Insurance brokers
- Reinsurance brokers

In addition, Act 26/2006 also regulates and contains certain special rules for a sub-type of insurance agents which are bancassurance intermediaries ("operadores de banca-seguros"). Those insurance agents distribute insurance products through the networks of credit institutions. They can also be exclusive or tied, like any other insurance agent. All the different types of insurance intermediaries may use third parties assisting insurance intermediaries in winning over clients and carrying out limited ancillary activities of administrative nature. Certain 'auxiliares externos', with specific training requirements may also provide assistance -advice- to clients ('auxiliares asesores') (article 8 Act 26/2006).

In **Slovenia**, the main distinction is between an insurance agent and an insurance broker as well as 'dependent broker-agents'. In all cases, brokers have to obtain a license to dispense their services. Finally in **Denmark**, there is a strong divide between a tied agent and a broker, but lower level distinctions are less clear.²¹⁰

Definitions based on activities

By contrast, the **UK** regulatory legal framework is largely based on market activities rather than persons and for the most part, it requires those engaged in the activities to be authorised. Therefore there are no definitions of the types of intermediaries, but a definition of activities. In **France**, intermediaries are also mostly defined by their

²⁰⁹ See responses to question 98.

²¹⁰ Note that the Consumer Credit Directive' distinction (Article 21(a)) is used for consumer credit in Denmark.

activities. The intermediary is the person that offers intermediation activities for remuneration according to Article L511-1 of the French Insurance Code.

Mixed definitions

However, despite this distinction activity/ persons, there seems to be no 'pure' definition of 'intermediary' in national law, but instead a number of mixed definitions.²¹¹ As a result, some confusion can occur.

For example, in **Germany**, the term intermediary (Vermittler) is used in Section 34d of Trade, Commerce and Industry Regulation Act (Gewerbeordnung) to define an insurance intermediary (Versicherungsvermittler). This is somebody, who, acting either as an insurance agent or as an insurance broker on a professional basis, wants to intermediate insurance contracts. A similar definition exists in the German insurance contract act (Versicherungsvertragsgesetz, VVG), section 59 VVG which states that (1) 'Insurance intermediary' within the meaning of this Act shall be insurance agents and insurance brokers." According to sec. 34f Trade, Commerce and Industry Regulation Act ("Gewerbeordnung"), an intermediary of financial assets ("Finanzanlagenvermittler") is somebody, who, on a professional basis, gives advice on certain financial assets intermediates such financial assets. The intermediation of credits is also mentioned in sec. 34c Trade, Commerce and Industry Regulation Act (Gewerbeordnung), but the term is not defined as for insurance and financial assets. In **Denmark**, the intermediation of insurance (formidling af forsikringer) is defined in the Insurance Intermediation Act, art. 1(1) as 'the activity consisting of, against remuneration, presenting, proposing or carrying out preliminary work in connection with the establishment of insurance contracts or reinsurance contracts, entering into such contracts, or participating in the management and performance of such contracts, particularly in respect of claims.' In the **UK**, The FCA Handbook Glossary defines an insurance intermediary as '*a firm carrying on insurance mediation activity other than an insurer*'. It defines 'insurance mediation activities' in terms of a closed list of 'regulated activities' carried in relation to a contract of insurance or rights to or interests in a life policy. The said activities find their source and definition in The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001: '(a) dealing in investments as agent (article 21), (b) arranging (bringing about) deals in investments (article 25(1)), (c) making arrangements with a view to transactions in investments (article 25(2)), (d) assisting in the administration and performance of a contract of insurance (article 39A), (e) advising on investments (article 53), (f) agreeing to carry on a regulated activity in (a) to (e) (article 64)'.

5.1.2.2 Definition of 'agents, brokers and advisers' in national law

Agents

The term 'agent' is well defined in law. However, its definition can be located in specialised legislation or rest on more general definitions.²¹² For example, in the **UK**, the notion of agent is not defined by the regulatory scheme. Instead, the regulatory scheme does not specifically define agent. Chitty on Contracts²¹³, an authoritative legal treatise in the UK defines agency at common law as '*a body of general rules under which one person, the*

211 This is for example the case in France, Poland, Ireland and the UK.

212 See for example Slovenia, Poland, Italy, Ireland, Finland, France, Denmark and Germany. We are uncertain about the situation in Spain.

213 Chitty on Contract, 31st edition.

*agent, has the power to change the legal relations of another, the principal*²¹⁴ and indicates that English law yields 'no simple answer' to questions about the definition of an agent.²¹⁵ The text indicates that the principal-agent relationship arises where '*one party, the principal, consents that another party, the agent, shall act on his behalf and the agent consents so to act. This consent is said to confer 'authority' on the agent and from this authority stems his power*'.²¹⁶

Brokers

The term broker is also defined in the national laws. But some variations exist focusing on different aspects of the role or capacity of a broker (license or fair advice). For example, in **Poland**, under the insurance mediation Act of 22 May 2003, Art.20, 'an insurance broker shall be a natural or legal person who has a permit issued by the supervisory body to pursue brokerage activities and entered in the register of insurance brokers.' In **Slovenia**, brokers are also defined by reference to the authorisation they must obtain. By contrast, other definition of broker focusses on 'fair advice'. In **Ireland**, 'insurance broker' means an insurance intermediary acting with the freedom of choice described in section 25B of the IIA 1995; IA 2000, s. 16. S. 25B provides that a person shall not act as, or hold himself out to be, an insurance broker in respect of life assurance or non-life insurance unless he is in a position to place insurance of that form with at least 5 insurance undertakings. Further the Consumer Protection Code 2012, states that, the term 'broker' may only be used where the principal regulated activities of the intermediary are provided on the basis of a fair analysis of the market.

Other Member States focus their definition of broker on the advice the broker gives as well as the fact that the broker is not bound to any of the companies it selects products from. Indeed, in **Germany**, The German insurance contract act, sec. 59 (3) VVG states: 'Insurance broker' within the meaning of this Act shall be anyone who contracts to arrange or conclude contracts of insurance for a client on a commercial basis without having being contracted to do so by an insurer or an insurance agent. An insurance broker shall be deemed to be anyone giving the person wishing to take out insurance the impression that he is providing the services of an insurance broker within the meaning of the first sentence above." This is also the case in **Finland**, where the Insurance Intermediation Act, art. 2, no. 1 states that the Insurance broker business shall [in this Act] mean: An activity consisting of providing the customer with advice on the basis of an analysis of as many as possible of the insurance solutions available on the market, and an activity consisting of presenting to the customer insurance solutions from one or several insurance companies without an explicit agreement to this effect having been entered into with said insurance companies."

Advisors

The term advisor is defined in national law but covers many variations in terms of sectors/products as well as the role given to the advisor. The term does not seem to be specifically defined concerning the insurance sector in **Finland** or **Spain** for example. In **Ireland**²¹⁷, a definition exist for an 'authorised adviser is a specific type of investment business firm that can provide investment advice on retail investment instruments, i.e. those investment

214 At para 31-001.

215 At para 31-005.

216 At para 31-006.

217 In Slovenia one of the three different licenses for stock exchange brokers is a license for investment advising (art. 186 Financial Instruments Market Act).

instruments set out in Section 25 and 26 (1) (a) of the IIA 1995, without the necessity to hold a letter of appointment and that can act as a deposit agent or deposit broker. In addition, it can receive and transmit orders to a product producer from which it holds a letter of appointment. An Authorised Advisor is obliged to recommend the most suitable investment product available in the market, regardless of whether or not it holds an appointment from the relevant product producer. But in **Italy**, the role of an agent is free and does not require an authorisation. In **Denmark**, a wider definition exists: that of a financial adviser. Under the new Act on Financial Advisers that will come into force 1 January 2014, art. 2(1), a Financial Adviser is a company which as part of its principal activity or side-line activity provides advice on financial products to consumers". Art. 2(2) states that advice is a personal recommendation for a consumer about transactions related to financial products." Those include credit agreements, deposits, insurance, pensions and investment products. Article 9 of the same act also defines what an independent adviser (Uafhængig rådgiver) is. However, as the Danish respondent indicated, apart from the aforementioned legislation, an adviser is mostly not defined, but can be viewed as a person that provides advice.

5.2 Business authorisations and licenses

Variations occur depending on the degree of control exercised (licensing or authorisation regimes) as well as according to the type of intermediaries object of such control.

Most countries operate a registration system instead of 'strict licensing and authorisation'. Indeed, in **Germany, Denmark, Spain, Finland** intermediaries need not obtain a license but instead register with their competent authority. In the **UK**, the regulatory scheme is based on the authorisation of regulated activities (including insurance and financial services) rather than types of intermediaries, under section 19 of the Financial Services and Markets Act 2000 (FSMA). In **France**, all insurance intermediaries are subject to an authorisation (licensing) regime under Article L512-1 of the Insurance Code.²¹⁸ It is ORIAS²¹⁹ that is charged with receiving applications and dispensing authorisations. ORIAS has powers to refuse authorisation or renewal as well as remove authorisations for wrongdoing. All intermediaries are subject to authorisation requirements such as obtaining the required professional qualifications and satisfying key requirements (e.g. absence of criminal record and demonstrating financial standing).²²⁰ Further not all member states operated a licensing/ authorisation system for intermediaries that were mutually exclusive. Indeed, in **Slovenia** for example, it is possible, at least in theory to register as a broker or an agent. By contrast in **Italy**, it is not possible to hold a double registration as an agent or a broker in the insurance intermediary register (except for automobile insurance). But it is possible to accumulate registrations for services in other financial sectors (for example credit brokerage).

Types of intermediary are regulated in some countries.

218 For more on insurance intermediation in France, see Jerome Speroni, L'ère de l'intermédiation financière, les cahiers pratiques de l'Argus de l'assurance, N ° 7263-7264.27 avril 2012. [arguselassurance.com, available online, https://www.arias.fr/documents/13705/17234/CP_Intermediation%20financiere_integral.pdf](https://www.arias.fr/documents/13705/17234/CP_Intermediation%20financiere_integral.pdf).

219 <https://www.arias.fr/welcome>.

220 For more on the requirements imposed to obtain authorisation from ORIAS and be entered on the official register, see Gregoire Dupont, L'ORIAS operateur du register unique des intermediariesm, in L'ère de l'intermédiation financière, les cahiers pratiques de l'Argus de l'assurance, N ° 7263-7264.27 avril 2012. [arguselassurance.com available online, https://www.arias.fr/documents/13705/17234/CP_Intermediation%20financiere_integral.pdf](https://www.arias.fr/documents/13705/17234/CP_Intermediation%20financiere_integral.pdf), p. 46.

5.2.1 Advisers

The control of **advisers** and requirements imposed on them vary based on the features of their independence. In Germany, an insurance adviser within the meaning of section 59 paragraph 4 Insurance contract Act (VVG) is *'anyone advising third parties on a commercial basis in respect of agreeing, amending or examining contracts of insurance or in respect of making claims arising under contracts of insurance upon the occurrence of an insured event or anyone representing the policyholder out of court vis-a-vis the insurer without receiving an economic benefit from an insurer without being dependent on him in any other manner.'* Independent insurance advisers need to be licensed according to sec. 34e GewO. Licensed insurance advisers are not allowed to receive commission from the insurance company but by definition may conclude fee-based agreements with the customers.

Other member states control advice through brokerage requirements. Indeed, in **Denmark** or **France**, advice is comprised into the licensing of brokers. Similarly in **Poland**, licensing of advisors is not specifically controlled, but insurance advisers are subject to licensing requirements applicable to investment advisors, consisting of an examination and registration on a list kept by the regulator.

But not all member states however apply the same stringent requirements. For example, in **Finland**, **Italy** or **Spain** there is no licensing requirements for advisors.

5.2.2 Insurance brokers

Brokers are subject to licensing. This is the case for example in **Finland**, **Ireland**, **Italy**, **Slovenia** and the **UK**. In **Poland**, brokers have to pass exams to access the profession and obtain a license to practice. The license is issued on condition of fulfilling formal and personal requirements, including three years of practice in the insurance industry. Similarly in **France**, **Denmark** and **Spain**, brokering activities require a license also based on a mixture of personal requirements such as experience and adequate qualifications and fitness for service, as well as technical requirements including holding professional liability insurance. In **Germany**, insurance brokers are defined in sec. 59 para. 3 of the Insurance Contract Act (VVG) According to this provision, insurance brokers are persons or legal entities who contract to arrange or conclude insurance contracts for a client on a commercial basis without having been contracted to do so by an insurer or an insurance agent. Furthermore, an insurance broker shall be deemed to be anyone giving the person wishing to take out insurance the impression that he is providing the services of an insurance broker. Insurance brokers need to be licensed by the chamber of commerce and industries according to the trade and craft's code of Germany (sec. 34d para. 1 GewO).

5.2.3 Insurance agents

Insurance agents can be exclusive agents or linked agents. The licensing requirements for those agent types vary between licensing to less stringent forms of control according to the level of dependency they may have and the perceived dangers such dependence may have on them.

For example, in **Germany**, The authorisation and licensing regime of agents is regulated by the Trade, Commerce and Industry Act which provides for an exception for tied agents (bound/restricted intermediary in German: 'Ausschließlichkeitsvermittler'). Those agents do not need to have an allowance, provided, that they work only for one provider per insurance-type and that the provider undertakes all legal obligations or liabilities for those agents.

In **Spain**, the system is based on Registration rather than strict licensing laws. There the registration is not carried out by the exclusive agents themselves, but by the insurance undertaking for which they act. The criteria to be met are much less compared to other intermediary categories. Indeed, the respondent commented that the *'the requirements to be met by the exclusive agents for its registration are the easiest ones among all the different types of insurance intermediaries'*.²²¹ However, for tied agents, additional requirements apply. Those include respect for commercial law and good practices for all members of the management body of tied insurance agencies and for the staff who directly take part in the insurance intermediation activities. Further, if the insurance agent is a corporate body, it must be a commercial company duly registered as a tied insurance agent. If the company has its share capital distributed into shares, they must be registered shares. Requirements concerning training as well as aptitude and knowledge also apply. All tied agency need to hold professional indemnity insurance in application of the Insurance Mediation Directive unless the all the insurance companies for which the tied agent acts expressly assume liability for its activity in their respective insurance agency agreements. Another requirement imposed on tied agent includes to have financial capacity amounting, on a permanent basis, to 4 % of the sum of annual premiums received, unless it is expressly agreed in the insurance agency agreement that insurance premiums are directly charged in the bank accounts of the policyholders or that the premium receipt is always issued by the insurance undertaking, and that the claims are directly paid by the insurance undertakings to the policyholders, insured parties and beneficiaries.

In other member states, there are no differences for the registration of exclusive and linked agents. This is the case for example in **France, Italy, Slovenia, Denmark** or **Poland**. In **Finland**, exclusive agents are also registered with the national authority. The criteria applied are more or less reminiscent of criteria applied in other member states, although, the respondent, representing the views of the national authority, regrets the absence of an evaluation of the ability of the agent to do the job.

5.3 Restrictions

A number of methods are used to apply restrictions on remunerations. In **Denmark, Spain, France, Poland** and **Slovenia** there are no restrictions on the salaries of employees.

By contrast, in the **Netherlands, Germany** and **Italy**, such restrictions exist. In **Italy**, no ceiling exists, but some limits are defined in the ISVAP (now IVASS) Regulation no. 39/2011. This Regulation provides specific rules concerning remuneration policies for insurance companies' personnel. Personnel is defined as comprising the general directors, managers with strategic responsibilities, officers with responsibilities and the highest level personnel of the internal control functions and the other categories of personnel, whose activity can have a significant impact on the undertaking's risk profile. Insurance and reinsurance undertakings shall identify, while formalising and explaining the relevant choices, the categories of subjects whose activity can have such impact, bearing in mind, amongst other things, the position, level of responsibility, level within the hierarchy, activity performed, delegations given, amount of the remuneration paid, and the possibility to take risk positions, generate profits or have a significant effect on other accounting items". In fact, IVASS does not have as a target the remuneration of those who intermediate or offers contracts, but it was mainly approved having in mind the apical

221 Answer to question C3 103.

positions (i.e. directors) working inside the company and in order to avoid high benefits for manager in time of crisis. Nevertheless, the general criteria and policy rules must be observed by the boards when dealing with every remuneration strategy inside the company as well as with insurance intermediaries.²²² These rules are very softly applied to insurance intermediaries, according to our respondent. In **Germany**, unlike the regulation of intermediaries (e.g. brokers, agents, investment advisers), there are only few provisions regarding variable remuneration of sales staff. There are two decrees that have been recently introduced providing regulation for employees of banks or insurance companies.

Similarly in Germany, the *decree on the remuneration-systems of insurances* (Versicherungs-Vergütungsverordnung, VerVergV) as well as the *decree on the remuneration-systems of banks* (Instituts-Vergütungsverordnung, InstVergV) both valid as of October 13th 2010 mainly deal with variable remuneration schemes for managers and so-called risk-taking employees. However, restrictions apply further to other employees. Indeed, according to section 3 VersVergV the enterprises must fix principles for the reimbursement systems of managers and other employees. Such systems shall reach the marketing strategies of the suppliers and avoid negative incentives, in particular conflicts of interest and entering unreasonably high risks. A similar provision can be found in section 3 InstVergV. According to section 3 Para 4 Nr. 1, conflicts of interest may be given especially if managers or employees depend significantly on variable reimbursements. Variable and fixed parts of remuneration shall be appropriately proportional.

5.3.1 Forfeiture

In **Germany**, the claim to a brokerage fee and reimbursement of expenses are excluded if the broker, contrary to the contents of the contract, also worked for the other party. This is according to section 654 of the German civil code. Since German law does not know warranty rights with regards to brokers, it is case law that widely extends this provision in order to forfeit fees if the broker violated his duties. However, besides cases of poor performance, there is little jurisprudence with regard to conflicts of interest. However, note a decision from OLG Karlsruhe, 18a U 127/93, concerning the cases of credit brokers where it was found that the brokerage may be forfeited if the broker received commissions not only from the customer but also from the provider, without disclosing the brokerage to the customer.

5.3.2 Caps on commissions

Denmark, Spain, France, Poland, Italy, Slovenia and **Finland** did not report any ceilings in place including the imposition of ad valorem caps or maximum commissions.

222 Art. 21 (Insurance and reinsurance intermediaries) 1. When defining the remuneration policies of insurance and reinsurance intermediaries undertakings shall ensure that remunerations and incentives are consistent with the principles referred to under article 4. According to this rules, we can recall Art. 4 where general principles are set: "Art.4. (General principles)- "(1) Undertakings shall adopt remuneration policies consistent with a sound and prudent risk management and in line with an undertaking's strategic objectives, profitability and balance in the long run. (2) Undertakings shall avoid payment policies based exclusively or mainly on short-term performance, which may favour excessive risk exposure. Note that in any case, there is a rule which could also be used to set a better control: in fact, art. 25 - titled ISVAP's supervision - provides that " 1. ISVAP shall supervise observance of the provisions of this Regulation, taking account of the nature, size and operational characteristics of the undertaking". This provision could allow IVASS (ex ISVAP) to supervise the respect of general principles of good remuneration policies also towards intermediaries, even where no specific complaint is presented by a client. Similar rules have been introduced, in application of EU directive 2010/76 , also in the bank sector for what concerns policies of remuneration of bank intermediaries.

When caps exist, they are very much localised and restricted. In the **Netherlands**, the restriction seems to apply to linked agents only. In **Ireland**, no caps exist, but the Insurance Act 1989 s.37 (as amended) allows for the reduction in commission to insurance intermediaries where the level of commission is considered excessive by the Central Bank. Section 38 allows the Central Bank to prohibit the paying of commission in the form of any benefit in kind, or as a loan of money made to an intermediary. In **Germany**, for substitutive (private) health insurances (health insurances that are appropriate to be a substitute for compulsory health insurance), the legislator has recently limited the initial commission or other remunerations to 3.3 per cent of the gross premium (calculated on a basis of 25 years) to be paid by the consumer. The introduction took place on April 1st 2012 and was preceded by a warning of the German Financial Supervisory Authority (BaFin) following a discussion about increasingly high commissions in the private health insurance sector. There is no jurisprudence focusing on this duty yet.²²³

5.3.3 Duration of insurance contracts

The **Italian** legislator has recently approved rules concerning the duration of the insurance contracts. These rules provide for automobile insurance, for example, that all contracts have to be concluded for one year without possibility of automatic renewal. Clauses setting automatic renewal are void. This rule is intended to improve competition and free movement of clients from one company to the other. It is evident nevertheless, that this also has an impact on relations between insurance companies and intermediaries with reference to the setting of entry commissions.

5.4 Bans

A general ban on remunerations with regard to the intermediation of investment products was proposed for inclusion in MiFID II.²²⁴ Although a general ban did not reach the required majority²²⁵, a more limited ban was introduced into Article 24 of the MiFID II proposal. According to this provision, an intermediary 'shall not accept or receive fees, commissions, or any monetary benefits' from any 'third party'²²⁶ in case 'the investment firm informs the client that the advice is provided on an independent basis' (No. 6)²²⁷ and for 'portfolio management' purposes (No. 7). More specifically, MiFID II Art. 24 specifies in which situations investment advice qualifies as being independent. When the client is informed that the advice is given on an independent basis, the investment firm shall not accept fees, commissions or any monetary benefits paid or provided by a third party. As a result, the MiFID makes provisions to protect consumers who believe to be independently advised.

223 By contrast, the prohibition of special provision (still in Germany) is the object of jurisprudential debate. Special provisions are the ability for an intermediary to pass on or share its remuneration. We explore those questions.

224 20.10.2011 COM(2011) 656 final 2011/0298 (COD) (repealing Directive 2004/39/EC (MIFID I))

225 see Handelsblatt 27.09.2012 "EU-Parlament kippt Provisionsverbot für Finanzprodukte" (EU-Parliament refuses ban on provision for financial products.)

226 Third party is the legal expression for those legal or natural persons which are not partner in the contractual relation between intermediary and client. Thus suppliers but also any other person the supplier may use for remuneration are prohibited from providing financial incentives to the intermediary with regard to this specific client advised by the intermediary.

227 Alinea 3 first bullpoint of this Article requires that investment firms disclose whether the advice is provided independently or what restrictions occur with regard to market analysis, selection of products and ongoing suitability assessment.

Fees and commissions and other forms of remuneration for intermediation and advice were also targeted by the proposal for a Directive on insurance mediation from July 3, 2012 (IMD II) which intends 'to enhance the suitability and objectiveness of advice'²²⁸, especially by proposing transparency requirements which should help to cope with conflicts of interest in this sort of 'principal-agent relation'.²²⁹

The similarities in the rules regarding the remuneration systems for financial intermediaries in all three areas in the existing EU proposals and analysis are intended.²³⁰

The present EU financial services framework (credit, investment and insurance)²³¹ recognises the specificity of intermediated marketing of financial services if the sales' person is linked to the supplier or to third persons by *variable remuneration systems* independent of the time and labour invested into such intermediation. The proposed regulations assume that such dependence can cause a *conflict of interest* (Article 17 IMD II²³², 23 MiFID II) between supplier and client so that *adequate, true, complete and informed advice* to clients may be jeopardised.²³³

The section highlights the main features used to control remuneration in the member states studied. It shows a wide variety of methods used since bans or limitations may concern remuneration methods, accumulation of fees and commission, use of net-premiums for agents or gross-premiums for advisers.

5.4.1 Forms of remuneration banned

We found no evidence of blanket bans on remuneration methods. Yet, remuneration methods are often restricted, but limited to one or a few categories of intermediaries or restricted to certain complex products.

For example, in **Ireland**, there are no prohibitions regarding remuneration methods as such but the 'Consumer Protection Code 2012 requires that remuneration arrangements with employees are not structured in such a way as to have the potential to impair the regulated entity's obligation to act in the best interests of consumers. Where a product producer pays commission to an intermediary based on levels of business introduced, the product producer must be able to demonstrate that these arrangements do not impair the

228 Explanatory Memorandum 1.1.

229 3.2. In 3.5 with regard to Chapter VI it is explained: "In terms of achieving higher consumer protection, these provisions offer higher transparency compared to the original Directive (2002/92/EC) regarding the nature, the structure and the amount of the intermediary's remuneration and provide clarity with regard to the principal-agent relationship, including how this may impact on advice. Consumer protection has moved forward significantly over the last years, and consumers are today increasingly information-seeking and cost-conscious. Disclosure of the different elements of the total price - including the intermediary's remuneration - will enable the customer to choose on the basis of insurance cover, linked services (for example if the intermediary does claims-handling) and price. This will further ensure suitable, cost-efficient products and intermediary services for consumers. Mandatory disclosure of remuneration should have positive effects on competition in insurance distribution as it would ensure that consumers receive wider information on products and costs, as well as possible conflicts of interest. It will be easier for consumers to compare insurance covers and prices between products sold through different distribution channels."

230 Recital 42 reads: "The European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) should work together to achieve as much consistency as possible in the conduct of business standards for retail investment products that are subject to either [MiFID II] or to this Directive through guidelines."

231 The fourth category of financial services: payment services do not share the element of a capital placed with somebody else the access to whom could be mediated while the fee is related to the amount of the invested capital.

232 Recital 29, 42, 50 IMD II with direct reference to MiFID II.

233 See FN 229.

intermediary's duty to act in the best interests of consumers and do not give rise to a conflict of interest.'

In **France**, specific restrictions contained in article R142-10 of the Insurance Code, limits life insurance remunerations.

In **Germany**, the restriction targets insurance advisers. They are not allowed to receive financial benefits from the insurance provider (section 34e (3) trade and crafts code (GewO) and section 59 paragraph 4 Insurance Contract Act). Also, according to sec. 17 of the decree on the intermediation of financial assets, the intermediary is not allowed to receive any benefits (Zuwendungen) from third parties other than customers unless he has informed the customer in due time before concluding the investment about the existence, type and amount of those benefits and the benefits cannot interfere with the customers' interest in 'proper intermediation and good advice.'

In **Poland**, *'according to Art. 79 Subsection 4 of the Financial Instrument Trading Act the agent of an investment company is allowed, while performing the activities based on the agency agreement concluded with the investment company, neither to receive any payments from the clients of the investment company nor to receive any payments made by the investment company for the benefit of the above clients. According to point 13 of the Principles of Good Insurance Practices, within their power, insurance companies shall make every effort to ensure that insurance agents do not take any material advantages at the expense of insurer's customer. Insurance companies ensure that the settlements on fees and other benefits offered by insurance agents do not encourage fraudulent activities.'*²³⁴

In the **UK**, a ban targets Retail investment advisors who may not charge commission for investment advice but must agree a fee in advance with a client. Indeed, the Retail Distribution Review (RDR) was set up with the aim to improve clarity for people who are looking to invest, raise the professional standards of advisers and reduce the conflict of interest found in remuneration for adviser services.²³⁵ The RDR aims to ensure that consumers are offered a transparent and fair charging system for the advice they receive; consumers are clear about the service they receive; and consumers receive advice from highly respected professionals. To do so, the RDR applies to all financial advisors in the retail sector, regardless of the type of firm they work for (this includes banks, product providers, independent financial advisers and wealth manager or stockbrokers) and imposes a ban on commissions. The ban was adopted with an entry into force as at 31 December 2012.²³⁶ The ban concerns the sale of investment policies such as pensions, annuities and unit trusts, but it does not cover mortgages and insurance policies. Other "pure protection" policies, such as life and health insurance, can still be sold on a commission basis (including PPI).²³⁷

In **Finland** and **Denmark**, life insurance intermediaries are restricted from receiving commissions on mediated insurance products. The motivation behind the bans is to protect consumers from improper advice and to clarify the role of independent intermediaries. To do so Art 17 of the Danish Act bans any dependent relationships and Art. 14 (a) (2) extends not just to commissions but all kind of remuneration from the supplier side

234 Answer to Question C4 114.

235 Source: <http://www.fsa.gov.uk/about/what/rdr/firms>.

236 For a short guide on the ban, see http://www.fsa.gov.uk/static/pubs/consumer_info/rdr-consumer-guide.pdf.

237 Source: <http://news.bbc.co.uk/1/hi/business/8589042.stm>.

(‘commission or other remuneration’).²³⁸ The formulation of Article 17 may sound strange to labour lawyers who across Europe define a labour contract using ‘subordination’ as a main characteristic to and justify protective regulation.²³⁹ Indeed, Article 17 states:

“(1) An insurance broker undertaking shall only represent the customer.

(2) An insurance broker undertaking may not directly or indirectly have such connections to an insurance company that are likely to place doubt on the independence of the insurance broker undertaking from insurance company interests if they are not a consequence of the mutual ownership relationship between the undertakings.

(3) An employed insurance broker may not be dependent upon the interests of an insurance company through employment or through other forms of association with insurance companies or groups of companies connected herewith.”²⁴⁰

Current legislation in **Sweden** allows insurance intermediaries to receive commission for the same mediated insurance products although discussions are underway as to a potential ban.²⁴¹

In the **Netherlands**, a ban came in to force as of 1, January 2013. It concerns the payment of commissions to independent financial advisers. The ban also applies to product providers who sell their products directly to consumers (advice or execution only). But the ban is limited to products that could have a significant impact on the financial position of consumers, if they are poorly advised. This includes, complex financial products (e.g. unit-linked insurances, annuities), mortgages/home loans, payment (protection) insurance products to consumer, funeral insurance products, life insurance products and MiFID investment services that are rendered by financial service providers that are exempted from the MiFID regime under article 3 MiFID (national regime). Therefore a number of products can still be sold on commission. This includes simple risk products, such as travel insurance and house/homebuilding insurance, investment services (although those products are supposed to be caught from 2014 onwards). The ban also does not apply to trail/ on-going commissions on products which were sold before 2013.²⁴²

Further restrictions apply to brokers. For example, in **Spain**, *‘insurance brokers cannot receive from insurers any type of remuneration other than commissions on insurance premiums. This implies that an insurance broker cannot receive a commission from an insurer based on the level of sales (e.g. rappels, commissions which increase depending on the level of sales, etc.). The purpose of this provision is to preserve the independence of insurance brokers’.*²⁴³ Similarly in **Finland**, the insurance broker may get his

238 Danish Insurance Intermediation Act (Act no. 401 of 25 April 2007) art. 14a(2): “An insurance broker undertaking may not receive commission or other remuneration from the insurance company in connection with the specific customer relationship.” Art. 17: “(1) An insurance broker undertaking shall only represent the customer. (2) An insurance broker undertaking may not directly or indirectly have such connections to an insurance company that are likely to place doubt on the independence of the insurance broker undertaking from insurance company interests if they are not a consequence of the mutual ownership relationship between the undertakings. (3) An employed insurance broker may not be dependent upon the interests of an insurance company through employment or through other forms of association with insurance companies or groups of companies connected herewith.”

239 L.Nogler, *The «Subordination» in European and Comparative Law*, Trento, Dipartimento di scienze giuridiche, 2007; M. Freedland, N. Kountouris, *The Legal Construction of personal work relations*, Oxford, Univ. Press, 2011

240 Response and translation by Tanja Joergensen

241 Andreas Friberg, Magnus Listermar, *Market power relationships among life insurance intermediaries – the power of giants*, degree thesis, Stockholm university, Spring 2011, p. 1.

242 Source: Anneke van Es, AFM Supervisory Officer, *A ban on commission in the Netherlands*, powerpoint presentation, ECRC financial services conference, Hamburg June 2013, on file with the author.

243 Answer to Question C4 item 114.

fee/commission only from his client and not from the insurance company whose products he sells. There is no such restriction for the sale of investment products however.

There are little limitations imposed by law to the accumulation of fees and commissions. Indeed, most legal experts consulted, indicated that no rules existed preventing such accumulation. This includes **Spain, Finland, Italy, Ireland, Poland, Slovenia** and the **UK**. In **Spain** however, while such restrictions do not exist for investment firms or for insurance intermediaries, they are in place for management companies and custodians of mutual funds and pension funds. Those see their fees limited by law and the same limits are applied to the accumulation of the fees of these management and custody fees and other fees payable by the funds to other funds or private equity entities in which said funds may invest their assets (i.e. sum of all the fees paid by the mutual fund or the pension fund shall not exceed in any event those maximum mandatory limits). In **Italy**, no prohibition exists in law strictly speaking. Nevertheless, concerning insurance, the same subject cannot be beneficiary and intermediary for the same product (i.e. banks cannot be insurance intermediaries and beneficiaries of the sold products). This is a special case in which the law identifies a static conflict of interest and requires the respect of the separation of roles.

There seems to be little by way of restrictions on the use of premiums (both net and gross) in national law in the member states studied.²⁴⁴

Interestingly, the terms net premium and gross premium are not legally defined in most of the member states surveyed. The only exceptions are found in **Germany**, the **UK** and **Ireland**. In **Germany**, the Insurance Act refers to 'premium', although it is our understanding that in that case, it is in fact gross premiums that are the focus of the legislation.²⁴⁵ In the **UK**, we found a similar situation with the term premium being the only one defined. The FCA Handbook Glossary explains: *'the premium that is calculated to provide the basic sum assured under a with-profits insurance contract taking into consideration only the mortality and interest rate risks and using the same assumptions as used in the calculation of the mathematical reserves.'* In **Ireland**, the term premium is also defined by law in the Insurance Act, 1936, s. 3. It means any money or money's worth payable or paid to any person who carries on an assurance business and who in consideration of such money or money's worth undertakes any liability under any policy, bond or certificate. However there seems to be no distinction between gross and net premiums.

Table 24 shows the variations which a ban on commission can take.

244 The only exception is Germany (see section on special provisions).

245 The respondent indicated: 'The insurance contract act only refers to Premiums, always meaning "gross premiums". (see division 3 "premium", sec. 33 ff. VVG. "Gross premiums" are mentioned in the law regarding the supervision of insurance undertakings ("Versicherungsaufsichtsgesetz, VAG"). Section 12 (4a) states: "In substitutive medical expenses insurance, a loading of 10 per cent of the annual zillmerised gross premium shall be charged to the insured, allocated annually and directly to the ageing provision (...)". (Note: zillmerisation is a method of calculating reserves in life insurance that allows for the acquisition costs incurred when a contract is written).

Table 24: Overview of EU Member States having introduced a ban on commission

MS	SCOPE OF INTERMEDIARIES	SCOPE OF PRODUCTS	MAIN APPROACH AND OTHER REGULATORY MEASURES
Finland (2005, transition)	Brokers	All insurance	Separate broking from agent activities and make broker pricing transparent via net quoting
Denmark (2006, transition)	Brokers	All insurance	Mandatory net-quoting system
United Kingdom (2013)	All financial advisors (tied & independent) giving advised sales (i.e. with recommendation)	Investment products (packaged incl. CLI) <u>Not:</u> risk insurance (not risk life insurance) or mortgages, or non-advised, direct or execution-only sales	Ban on provider influence on remuneration, Pre-agreed advisor charging Transparency of charges (link charges to services not sales volume) Providers still able to facilitate payments <u>Plus:</u> <u>comprehensive disclosure</u> regarding remuneration Higher standards of service on behalf of independent financial advisors Minimum qualification standards
Netherlands (2013)	Independent financial advisers	Complex products (investments, savings, linked products, life insurance (risk and CLI), Mortgages, income insurance (PPI, disability), funeral insurance) <u>Not:</u> simple risk products; and not investment services (ban will be extended to them in 2014, and thus ban will apply to banks and investment firms for portfolio fee incl. for execution only)	Standardised disclosure document Open standard for remuneration (reasonable fee) Ban on bonus provisions for non-life insurances (ban on override commission e.g. in travel)
Australia (2012)	Independent financial advisers	All retail investment products <u>Not:</u> risk products, mortgages and health insurance	Ban on: transaction-based commissions volume overrides, rebates from platform providers to distributors 100% fee-for-service asset-based trail commission Requirement to opt-in/renew on-going service agreement every 2 years <u>Plus:</u> Fiduciary duty to act in customers best interest ASIC list of conflicted remuneration

Source: Various sources including Tower Watsons Emphasis 2011/3, own presentation.

5.4.2 Effects of a ban

A ban implies that the banned phenomenon does no longer exist. Yet, because the bans described are restricted the study found evidence of continuing commissions being paid.

5.4.2.1 Finland²⁴⁶

Of the countries included in this study, Finland was the first to introduce a ban on commissions for insurance brokers.²⁴⁷ It is forbidden for an independent insurance broker

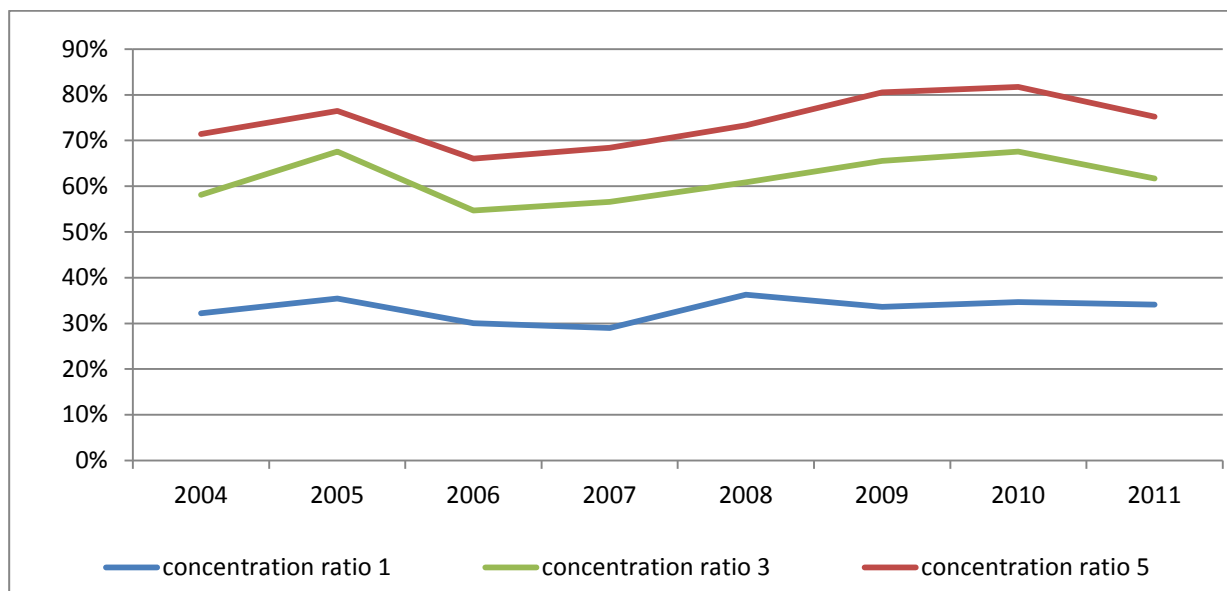
²⁴⁶ Relevant literature for this section includes: Federation of Finnish Financial Services (2013): Finnish Act on intermediation and the remuneration model for brokers; Financial Supervisory Authority (2012): Insurance Brokers. (different years); Friberg, Andreas; Listermar, Magnus (2011): Market power relationships among life insurance intermediaries. - The power of giants. Stockholm University, Stockholm. School of Business; VAKUUTUSVALVONTA (2005): Conditions required by general good for EEA-insurance intermediaries. In: Act on Insurance Mediation (570/2005).

²⁴⁷ It has been in force since Sept 1 2005.

to accept commissions from insurance companies. His remuneration is only paid by the consumer in the form of an advisory fee.²⁴⁸

Andreas Friberg and Magnus Listermar (2011) analysed the ban on commission in the Finnish insurance market. According to the authors, the statutory amendments in Finland could have a negative impact on the competitive structures of the life insurance market and hence adversely affect the consumer with regard to the price and the number of intermediaries. The Finnish financial supervision authority (FSA) estimated the return on sales for insurance intermediaries dependent on market share, market growth and degree of concentration for the years from 2004 until 2009. The return on sales is bigger, the more market shares a firm has (Friberg and Listermar 2011). At the time of the study Friberg and Listermar only had access to data up to 2009. The Figure shows the development of the concentration grade of the 5 largest Finnish life insurance companies from 2004 to 2011. It is obvious that the market share of the third and five largest intermediaries during the 3-year transition period (from Sept 1 2005 until Aug 31 2008) constantly rises, reaching its maximum in 2010. A significant decline can be witnessed thereafter.

Figure 31: Concentration ratio of the 5 largest Finish life insurance brokers, 2004-2011



Source: Financial Supervisory Authority 2012.

Although the authors were able to prove a positive cohesion between market concentration and return on sales, it is not possible – given the available data – to verify if the continuous increase of the degree of concentration between 2006 and 2010 actually stems from the ban on commission. An additional explanation could be the financial crisis, which has been influencing the European economy since 2007. Particularly, small companies who could not withstand the growing pressure had to withdraw from the market, leaving market share for others to take over. Moreover, large legislation amendments, such as the ones conducted in Finland need a certain timespan for their implementation. Chapter 2.3.3 revealed that acceptance for these remunerations have yet to grow and many consumers are unwilling to pay the high fees of the intermediary. This can be seen from the development of paid commissions.²⁴⁹ While slightly rising again in 2007 the following year

248 See VAKUUTUSVALVONTA 2005, p.27.

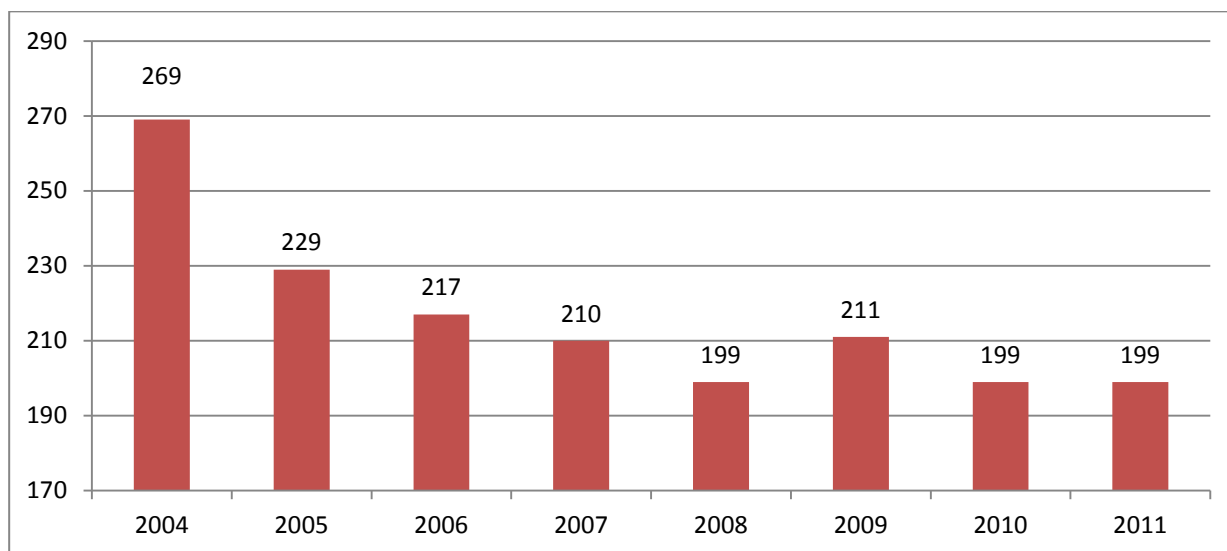
249 See Figure 33.

a drop of 22.3 % can be witnessed. As early as 2011 this low had been overcome. This could be indicative that consumers were able to adjust to the new system.

According to the Federation of Finnish Financial Services (FFI), both the Finnish authorities and consumers believe that the ban on commission serve its purpose. According to the FFI, the new law has a positive impact on consumer protection. It decisively contributes to the avoidance of collision of interests. Before the changes were adopted on Sept 1 2005, many insurance brokers sold products only from certain insurance companies. The legislation enables better transparency and enables consumers to better distinguish between a tied and an independent adviser. Although the possibility of complementary advice no longer exists, a potential for undersupply of advice in the market could not be verified. According to the FFI, there is no empirical evidence that the supply of insurance products dropped. Furthermore there is no evidence that fee-only advice resulted in higher costs for consumers (source: Federation of Finnish Financial Services 2013).

Although the FFI (2013) claims that the number of insurance brokers in Finland has been consistent since 2005, the FSA numbers show different results (see Figure 32). Particularly since the implementation of the ban on commissions in 2005, and throughout the 3-year-long transition period, a constant drop in the number of insurance brokers can be witnessed, with only 199 brokers left in 2011.

Figure 32: Number of insurance brokers in Finland, 2004-2011



Source: Financial Supervisory Authority 2012, own presentation.

This development supports Friberg's and Listermar's view that the establishment of fee-only-advice would lead to a drop in active insurance brokers having a negative impact on competitive structures. However, the current data does not indicate how far this decline could impact the competitive structures, since the market concentration is admittedly subject to variation. Over all however, it can be assumed that this decline would remain relatively steady.

The development of brokers' remuneration (Figure 33) clearly shows that the Finnish insurance brokers, despite a ban on commission, found a way to adapt to the new legal order. As early as 2011, the remuneration of fee-only-advice was equal to the level of the remuneration earned through commissions.

Figure 33: Development of the remuneration of brokers in Finland, 1996-2011



Source: Federation of Finnish Financial Services 2013, own presentation.

Due to the development of premium payment in the years 2009 and 2010, consumers' scepticism can be assumed. The swift rise in 2011 however shows that consumers have adapted to the new system relatively quickly. These development is supported by the development on the total amount of premiums of the biggest brokers and their concentration ratio between 2009 and 2011.

Table 25: Premiums and concentration ratios in the Finish broker life insurance market, 2004-2011

		YEAR							
		2004	2005	2006	2007	2008	2009	2010	2011
premiums of biggest insurance brokers (EURmIn)	1st	498.61	484.49	409.49	393.64	502.01	361.28	356.01	406,05
	2nd	212,30	221,86	232,59	272,55	233,15	184,06	168.91	178,30
	3rd	190,02	216,75	102,61	101,66	106,97	159,89	146.29	150,40
	4th	117,02	63,79	91,73	93,15	102,54	89,91	88,01	101,32
	5th	88,64	58,47	63,14	67,81	70,75	70,97	59,22	59,32
	Total	1549,66	1366,34	1361,96	1357,16	1384,45	1075,56	1043,27	1190,73
concentration ratios	CR1	32.18%	35.46%	30.07%	29.00%	36.26%	33.59%	34.63%	34.10%
	CR2	45.88%	51.70%	47.14%	49.09%	53.10%	50.70%	52.27%	49.07%
	CR3	58.14%	67.56%	54.68%	56.58%	60.83%	65.57%	67.60%	61.71%
	CR4	65.69%	72.23%	61.41%	63.44%	68.24%	73.93%	76.03%	70.21%
	CR5	71.41%	76.51%	66.05%	68.44%	73.34%	80.53%	81.71%	75.20%

Source: Financial Supervisory Authority 2012.

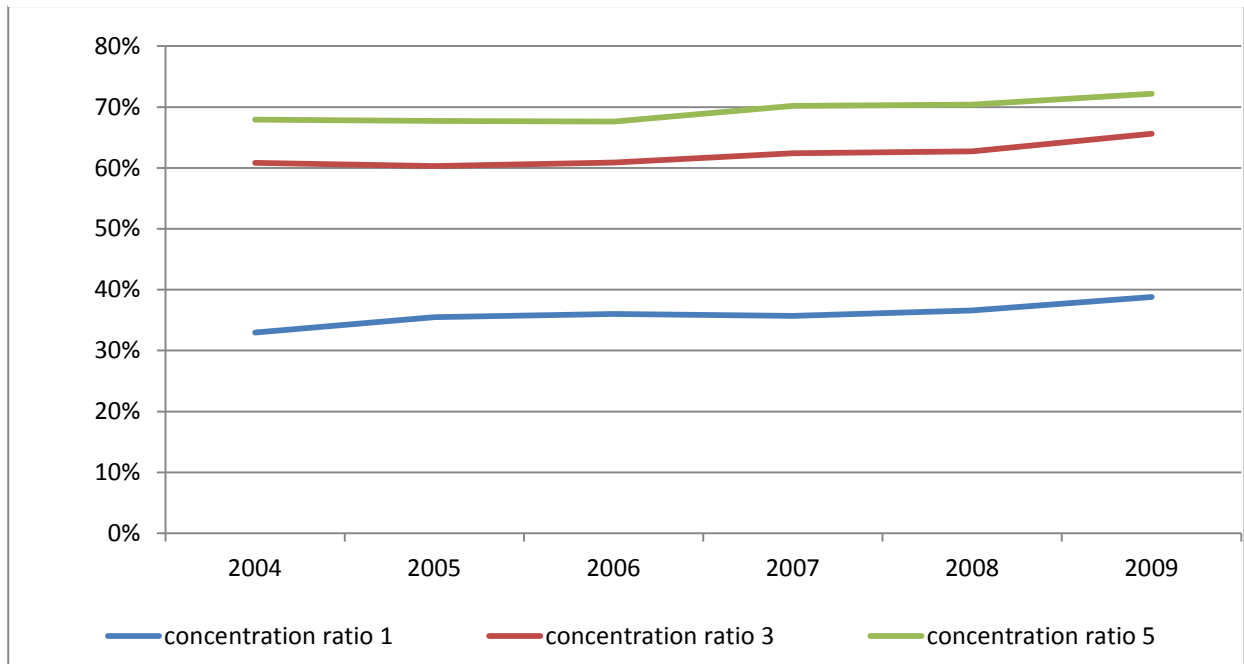
5.4.2.2 Denmark

Since 1st July 2006, Denmark banned commissions for independent insurance brokers with a transition period of five years. This was, contrary to the Finnish experience, to allow for a more realistic and feasible change from the commission-based model of remuneration to a fee-based model of remuneration.²⁵⁰

The study by Friberg and Listemar also gives a useful overview on the development of the concentration ratio of Danish life insurance brokers as shown in the Figure. We can observe a slight increase throughout the whole observation period. The graph shows that the largest Danish broker gained most of the market share between 2004 and 2009. Considering the fact that the concentration ratios have remained comparatively steady since 2004, it is difficult to clearly conclude whether or not the ban on commissions introduced in 2006 has had any significant impact on the market concentration and thereby competition in the Danish insurance market. A more in-depth analysis would be required to fully assess the effects of the ban. Such analysis is difficult to undertake with the data currently available.

250 See DFSA 2007.

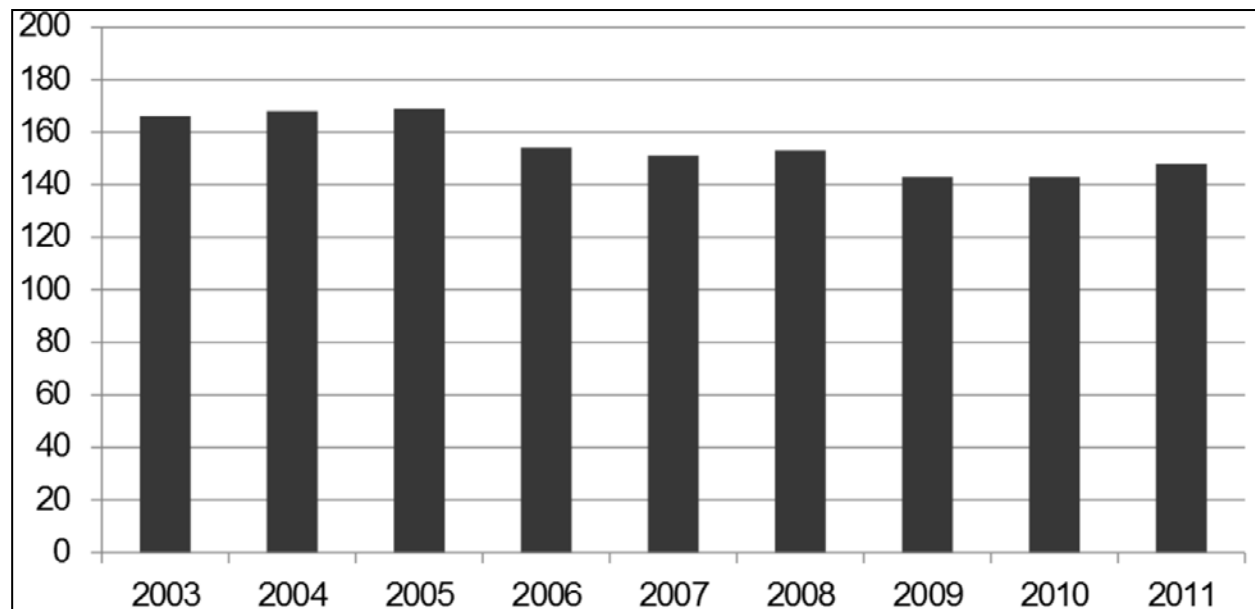
Figure 34: Concentration ratio of the 5 largest Danish life insurance brokers, 2004-2009



Source: Friberg 2011 as quoted by the FSA, Denmark.

As was the case in the Finnish insurance market, the ban on commissions in Denmark has led to a decrease in the number of active brokers on the market (of around 12%) between 2005 and 2009 (as shown in the Figure).

Figure 35: Number of Danish insurance brokers, 2003-2011

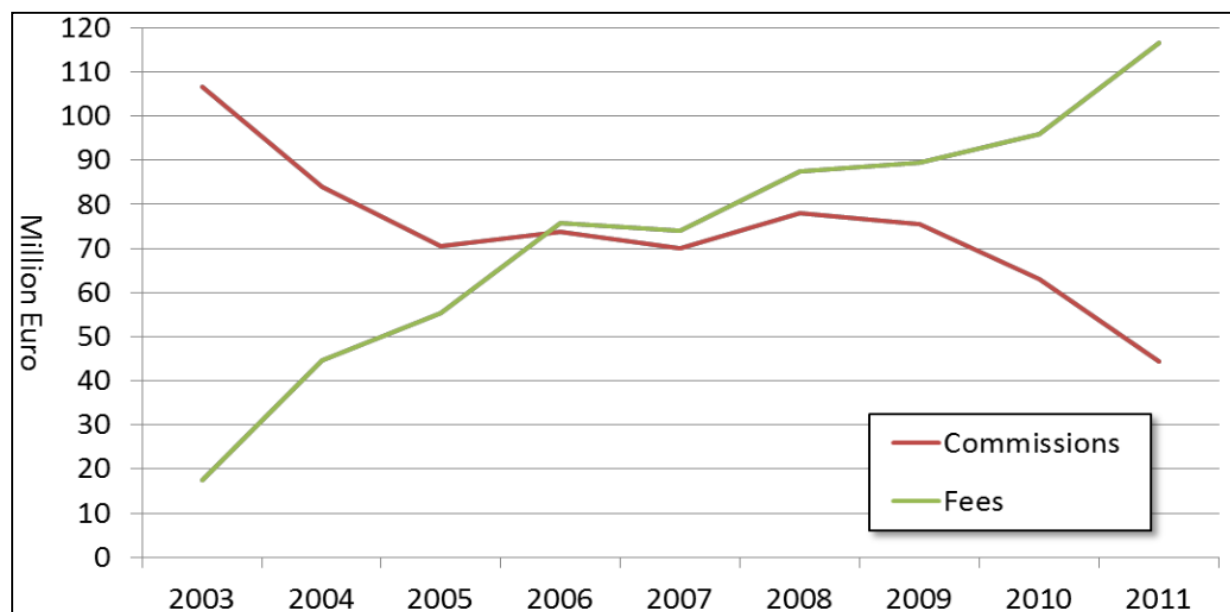


Source: Forsikring & Pension 2013.

Since 2003, commissions started to decline while fees steadily increased. The ban has had no significant impact on the total size of broker remuneration. The total value is almost

unchanged, at over 115 EURmln, by the end of the transition period (in 2011) as declining commissions were replaced²⁵¹.

Figure 36: Development of remunerations of brokers in Denmark, 1996-2011



Source: Forsikring & Pension 2013

Another effect of the ban, possibly unintended, on the life insurance market, has been for brokers to bypass the ban. This is possible because on the Danish market, a large proportion of pension premiums (44% of all premiums paid in 2011) emanate from negotiations between companies and brokers, but with premiums that remain the responsibility of employees. This puts little incentives on employers to negotiate a low fee. Further, employers conduct negotiations on terms of contract and price. As policy owner they only have to pay for this with the conclusion of a non-life insurance contract. This means the employees have no influence on the pricing of their life-insurance contracts. It may therefore be advisable to extend the Danish regulation in relation to remuneration of brokers and for example include a ban on the take-over of compensations by insurers.²⁵²

251 See Figures for development of the number of brokers and amount of total remuneration by model in the Danish insurance market.

252 See Forsikring & Pension 2013 24ff.

5.4.2.3 United Kingdom²⁵³

The Retail Distribution Review (RDR) is the latest legal change in the regulation of the mediation of financial services. It includes a ban on the payment of commissions which is not limited to brokers (Thorun und Niemeyer 2012, p.17ff). Due to the fact that the ban has come into effect only very recently, data analysis is not yet possible to evaluate the impacts on respective market participants. However, some studies anticipating possible effects of the RDR on the British financial services market are available.

Expected impact on advisers

According to Deloitte (2011, p.1), the number of advisers (investment managers) on the market is likely to fall by 15-20% and will lead to consolidation into institutions or networks. It is expected that the market power of the remaining advisers will strengthen intensifying competition among providers.

The largest British insurance company AVIVA issues the AVIVA Adviser Barometer since 2009. It shows results of a survey with financial intermediaries commenting on new regulations.²⁵⁴ The outcome was that 37% of all respondents at the time expected to withdraw from financial services business by 31 December 2012. Three years later, they were only 3.4% saying the same thing. This development suggests that British financial advisers accommodated themselves with the RDR and incorporated changes into their business models.

Expected impact on advice provision by banks

It is expected that a ban on commissions will impact banks. For example, HSBC plans to lay off 650 employees, thereby giving up its independent advice business to concentrate solely on the support of wealthier customers through external independent intermediaries (Grote and Robbins 2012). For the remaining customer groups, an internet platform will be launched that will effectively abandon the provision of customer advice by merely allowing for financial transactions free of charge. Similar approaches can be seen with Barclay's and The Royal Bank of Scotland. Note however, that independent advice through banks as a strategy is an exception. This is because most banks offer financial services in cooperation with selected partners. This is because being independent requires offering all available products on the market, including those of rival businesses (Thorun and Niemeyer 2012, p.33).

253 Among the vast grey literature on the subject of the recent ban on commissions in the UK, the following have been mainly used for this section: AVIVA (2012): Advisers getting fit for the future. Online verfügbar unter <http://www.aviva.co.uk/media-centre/story/16972/advisers-getting-fit-for-the-future/>, zuletzt geprüft am 26.07.2013.; BDO (2012): RDR to Result in Higher Consumer Costs and Advisers receiving 'Commission by Another Name'. Online verfügbar unter <http://www.bdo.uk.com/press/rdr-result-higher-consumer-costs-and-advisers-receiving-commission-another-name-bdo-res>, zuletzt geprüft am 27.07.2013; Deloitte (2011): Responding to the Retail Distribution Review: Shaking up investment management? Deloitte. London; Deloitte (2012): Bridging the advice gap: Delivering investment products in a post-RDR world. Deloitte. London; Financial Services Authority (2010): Distribution of retail investments: Delivering the RDR - feedback to CP09/18 and final rules. Policy Statement 10/6; Grote, Daniel; Robins, William (2012): HSBC scraps tied advice service; 650 jobs go. citywire. Online verfügbar unter <http://citywire.co.uk/new-model-adviser/hsbc-scraps-tied-advice-service-650-jobs-go/a584819>, zuletzt geprüft am 26.07.2013; Rostrum-research (2012): Retail vs. Financial Services: The battle for Consumer trust; Thorun, Christian; Niemeyer, Frank (2012): Towards a fairer deal for consumers and the financial industry. Hg. v. ConPolicy GmbH und Prof. Roll & Pastuch GmbH. Association of German Fee-Only Advisers (BVDH) and quirin bank AG. Berlin.

254 See Thorun and Niemeyer 2012, p.31.

Financial impact of the RDR

Impacts of the RDR on the whole financial services industry become noticeable mainly through costs that are caused by system adjustment. The Financial Services Authority (2010) divided these into one-time and on-going costs and estimated their height for the first five years after implementation of the RDR.

Table 26: Estimated costs for the financial services industry caused by implementation of the RDR

GBP MLN	INTERMEDIARY	PRODUCT PROVIDER	TOTAL
One-off cost	275-370	330-385	605-750
On-going cost	100-120	70-85	170-205
Net present value of costs for the next 5 years			1,400-1,700
Annual costs			305-370

Source: (Thorun and Niemeyer 2012, p. 34), according to: (Financial Services Authority 2010, S. Annex I), own presentation.

It is anticipated that early costs of up to GBP 370 million will arise for the whole industry. For adjustment from commissions to fee based advice only, estimated one-time costs of GBP 160 million could be expected (and be borne by the intermediaries). Additional costs occur from transparency obligations and, last but not least, from the advisors' training to adjust their qualifications to the new regulations (Financial Services Authority 2010, see Annex I).

Expected impact on customers

Costs for system adjustment are likely to be transferred to the customer. Altogether they will have to pay more for financial advice after the implementation of the RDR than before (Financial Services Authority 2010, Annex I). Another survey that includes over 280 independent financial advisers in 2012 has shown that 90% of respondents believe that remuneration of advisers, with the new system, will be just as high or even higher. Before the implementation of the RDR, the adviser, with an investment sum of GBP 50,000, received an average of 2.9% acquisition and 0.6% of portfolio commission. With the implementation of RDR it is expected that the same scenario will yield somewhat lower acquisition costs (2.8%), but running costs will rise about 0.2 percentage points. Altogether during the whole investment period, the customer will derive higher costs (BDO 2012).

Further one potential effect concerns the fact that many customers are not willing to pay charges for fee-based advice (Thorun and Niemeyer 2012, p.35). And when they are prepared to pay, willingness to pay is unlikely to cover actual costs. According to Rostrum-research, 9 out of 10 consumers would pay a maximum of 25 GBP per hour of advice (Rostrum-research 2012, p.13). The Financial Service Authority meets these fears arguing that the diminishing number of advisers (according to the latest findings) will not be as bad as expected and that commissions' based advice is not free of charge. With the new system, advisers will get the chance to convince sceptical customers of the true value of their advice (Financial Services Authority 2010, p.18). However a current study by Deloitte (2012) shows a much more worrying picture. Their study shows that just before implementation of the RDR, customers still have a problem appreciating the value of the

advice. 87% of customers having bought a financial product in the last three years thought that respective advice on the product was free of charge. Accordingly, it can be assumed that a number of customers will be surprised by fees from 2013 on. It is likely that 33% of respondents with a savings deposit below GBP 50,000 and 32% with savings deposits of more than GBP 50,000 will no longer use any financial advice if they have to pay a fee for it. 56% of respondents will reduce the frequency of advice in the future. As a consequence, a big part of customers will abandon advice under the RDR completely in favour of buying products directly from the provider. According to Deloitte, up to 5.5 million customers will fall into this advice gap, voluntarily or not (Deloitte 2012, p.2ff).

However here lies potential for financial services institutions and providers to bridge the gap. With the implementation of new standardized advice and internet sale platforms, Deloitte foresees a way to lead customers out of the advice gap (Deloitte 2012, p.10).

5.4.3 Limitation of an intermediary's freedom to offer "consumer rebates" on commissions and charge fees

In **Germany**, according to a German study carried out in 2011²⁵⁵ the vast majority of insurance contracts carry premiums bearing commission or brokerage that are hidden from the consumer (so called "gross premiums"). The question arose whether brokers or agents are allowed to share the commission they receive from providers with their customers offering a consumer rebate.²⁵⁶

In 2006, the Regional Court of Düsseldorf ruled that such commissions were compatible with the Constitution and with German competition law, thus allowing rebates in Germany. The defendant was the *Wiesbaden Association*, an entity charged with *ensuring the adequacy of legal and supervisory authority regulations on commissions*. The plaintiff was an insurance broker firm that had been denied authorisation by the *Wiesbaden Association* to receive commissions for their work, when it was to be passed on directly or indirectly to the policyholder, on the grounds of the general prohibition of consumer rebates. However, in 2010, an independent agent wishing to share commission with his customers filed a claim against the German financial supervision authority (BaFin) in order to remove this prohibition. In 2011, the Regional Administrative Tribunal of Frankfurt dismissed the claim and seriously doubted that the prohibition of *special advantages* would be compatible with the German Constitution. This could have re-opened the question of the validity of rebates in Germany, but the BaFin withdrew its appeal and therefore the initial 2006 court decision still stands.²⁵⁷

By contrast, in **Denmark**²⁵⁸, **Spain**, **France**, **Italy** and the **Netherlands** no limits on consumer rebates are identifiable. Although there are no specific rules prohibiting such special provision, the respondent for **Poland** was of the opinion that the conclusion of an agreement on sharing (passing on) the intermediary's remuneration with the consumer

255 See Beenken/Brühl/Pohlmann/Schradin/Schroeder/Wende, Nettotarifangebot deutscher Versicherungsunternehmen im Privatkundengeschäft, Mitteilung 1/2011 des Instituts für Versicherungswissenschaft an der Universität zu Köln vom 11. 2. 2011 p.12.

256 Note that net premiums are allowed in Germany.

257 According to Olbrich, in the development of insurance markets in Germany the prohibition of rebates lost its importance because of the introduction of commission-free net premium. The share of contracts sold on this basis made up only 1% of the total market in 2011. But there is a general view that net premium quoting will gain in importance over coming years (see: Beenken/Brühl/Pohlmann/Schradin/Schroeder/Wende, Nettotarifangebot deutscher Versicherungsunternehmen im Privatkundengeschäft, Mitteilung 1/2011 des Instituts für Versicherungswissenschaft an der Universität zu Köln vom 11.2.2011 p.13f).

258 Note that in fact a broker has to pass on to the customer any remuneration given by a foreign insurance company according to the Act on Insurance Mediation no 930 of 18 September 2008 - section 14 a,4.

may be considered as an unfair market practice in the meaning of Art. 4 of the Act on Unfair Marketing Practices.²⁵⁹

5.5 Information and transparency

There have been a number of measures to improve transparency of products and effects. This includes financial education so that consumers can better understand the disadvantages a product may produce. It contains important amelioration of product information to consumers including cooling-off periods in insurance, credit and investment. It also provides for adequate, complete and correct advice.

But these corrective measures are limited to a situation where the supplier does not give sufficient advice. Where a supplier or his intermediary provides intentionally wrong advice and misrepresents the product the consumer, even having obtained adequate information, may be stirred away from its appropriate use. This is the case when, for example, an insurance intermediary describes primarily the risk and its possible consequences for the consumer while its feasibility, cost, affordability and necessity remains obscured.

Because the existence of a (high) commission indicates that there may be an inherent danger of misrepresentation, a number of rules in all financial services require the disclosure of hidden commissions. The reason for this is that it is assumed that consumers who know how much an insurance intermediary gets for having sold this product to him or her will be more cautious and seek a second opinion.

But such disclosures are often not sufficiently sanctioned and are not easily understood in the way they are offered. (Percentage, Euro, time of payment). Especially vulnerable consumers may not even read this information and rely on the advice. Further, the question concerning which form is most apt to help make adequate market decisions is not clear. If expressed in a percentage of the amount, the definition of "the amount" may, as we have mentioned, be fictitious or irrational. Consumers may also be unable to do such calculations as many are unable to perform percentage calculation. If, on the other hand, the currency amount is indicated, it may seem to be minimal with regard to the overall sum of the insurance, credit or pension scheme.

Finally the providers have developed systems of provision payments in which the commission is not paid by the consumer but by the supplier to the intermediary (internal commissions). Alternatives include payments such as those in credit life insurance that are designed in a form of interest payment which is only necessary because the premium have to be paid in advance in order to give the lender a possibility to finance the premiums.

The duties of information and transparency have been introduced as a consequence of the implementation of EC directive 2002/92 on insurance mediation. Some of the transparency obligations in the Member States belong to supervisory law and therefore deal with the relation between public authorities and intermediaries (although they have some indirect benefits for the protection of consumers). Much transparency laws however have been developed to protect consumers directly against information asymmetry and conflicts of interest.

Whatever their origins, the rules identified in national law tend to control the existence and extent of transparency obligations vis-a-vis the role and dependencies of the intermediary, the amount of his remuneration, and the identity of the person paying such remuneration (where relevant).

259 Journal of Laws of 2007, No. 171, item 1206 as amended.

5.5.1 Transparency about the role and dependencies of the intermediary

Legislation requiring that the intermediary disclose its role and any dependencies (which may include disclosure of who pays the commission or fee to the intermediary) exist, although such obligations do not apply equally to all intermediary types or product types. We focus below on insurance only. Such obligations may also have their origins in diverse pieces of statutes or other sources.

It is important for consumers to clearly understand that the person they are dealing with is an intermediary and when it is the case, what the role undertaken consists of. As a result, and in line with European law, legislation at national levels requires disclosure of a number of pieces of information prior to a contract being concluded.

In **France** for example, this information is as follows: Prior to the conclusion of a first insurance contract, the insurance or reinsurance intermediary must provide information relating to his identity, registration, complaint procedures, as well as if relevant, any financial links with one or more insurance companies. Before any contract can be concluded, the intermediary also needs to provide information about whether or not the contract will be subject to exclusivity with one or more insurance company and if so, communicates the names of those companies. If the intermediary is not subject to exclusivity, but cannot access sufficient providers, communicate the name of the companies the intermediary works with. If the intermediary is not subject to exclusivity and claims to be providing an objective analysis of the market, the intermediary must have access to a sufficient number of insurance contracts available on the market in order to be able to recommend the contract which will be best adapted to the needs of the client.²⁶⁰ Further information is required if the intermediary has holdings (either direct or indirect) in the shares of an insurance company, if this holding (voting rights or capital shares) is of a value higher than 10%.²⁶¹ In this case, the intermediary must communicate this information to the client. Similarly, if an intermediary generates more than 33% of its turnover (in the preceding year) with a single insurance company, it is required that it discloses this information.²⁶²

Other information about the person paying the commission or fee is required by law in many of the countries studied, but not all.²⁶³ In the **UK** for example, with respect to pure protection products associated with retail investment sales, the regulatory guidance in COBS 6.4.11G states that a firm should consider including the following in its written statement of commission: (1) Amounts or values of commission rounded as appropriate to help the client understand the document (for example, large amounts might be rounded to three significant figures), (2) The names of the firms involved in paying and receiving commission or commission equivalent, (3) A plain language description of whether remuneration takes the form of commission or commission equivalent. Commission equivalent could, for example, be described as remuneration and services received from

260 As stated in Article L520-1 of the Insurance Code.

261 This is a requirement also present in Polish Law. Indeed, the insurance agent has to disclose to the client whether the agent represents one or more providers and at the client's request inform the client about the business name of such provider(s). Moreover, the insurance agent and the broker has to inform the client about shares held in insurance company giving the right to at least 10% of the votes during the meeting of shareholders and - in the case that the agent is a legal entity - about the shares held in the agent by the insurance company giving to the latter right to the mentioned number of votes at the agents' meeting of shareholders (See Art. 13 of the Insurance Intermediation Act).

262 See Article R520-1 of the Insurance Code.

263 According to our information, there was not sufficient clarity regarding Slovenia. Because of a reported ban on Commission, it appears that such an obligation does not exist also in the Netherlands.

XYZ Ltd", (4) The timing of payments and period over which they are paid, (5) For payments relating to the client's fund, examples of how much money might be taken, such as: (a) where the commission or equivalent is on an increasing basis, the amount to be taken in the first and tenth year in which it is paid, or (b) where the commission or equivalent is a percentage of the fund, the amount that would be taken if the fund was worth a certain value and the amount that would be taken if the fund was worth twice that value. This COBS guidance is applicable here because the ICOBS rules on disclosure of pure protection products require compliance with the COBS rules that are related to this guidance.

Moreover, it is important that consumer obtain this information regardless of how they get to start their relationship with the intermediary. The French experience here is worthy of notice. In **France**, some good practices were adopted regarding the use of price comparison websites to source insurance products. This is because, website that aggregate the data for consultation by consumers are not insurance intermediary themselves caught by the Insurance code. Yet, the way the information on those sites is disclosed can have an influence on the consumer's decision. Those good practices require that any economic links between the comparison website and insurance companies whose products are featured on the site. It also requires that any remuneration received by the companies featured be disclosed as well as explaining what influence it may have on the display of results. If the site also features intermediaries, as opposed to product from insurance companies themselves, those offers also need to clearly show that the consumer would be dealing with an intermediary.²⁶⁴

In **Ireland** and **Italy**, similar obligations to those laid down by law in France or the UK exist. They focus on providing fair advice to consumers and thus disclosing any 'affiliations' that may render the advice/ sale biased in some way. Further, under the Irish Consumer Protection Code 2012, the term 'independent' may only be used where the intermediary provides services on the basis of a fair analysis of the market and allows the consumer the option to pay in full for the service by means of a fee.

With regards to form, we were able to establish that in some member states at least, the use of a template for disclosure may be used. It is the case in the **Netherlands**, **Italy** and the **UK** for example.²⁶⁵ Those forms offer clear information concerning key facts about the insurance contract the consumer is about to conclude.

5.5.2 Transparency about the amount of remuneration

By contrast to transparency concerning the role and affiliation of intermediaries, full transparency about remuneration is not always required. Such transparency requirements vary depending on the type of intermediaries, as well as products. This section focusses primarily on investments, insurance and loan brokerage. Some differences in those transparency regimes were apparent, making for a murky legislative environment.

264 CCFS, Avis du Comité consultatif du secteur financier pour renforcer la transparence et la qualité des comparateurs d'assurances de dommages sur Internet (advice of the Consultative Commission for the financial sector to reinforce transparency and quality of online damages insurance comparison sites), http://www.banque-france.fr/ccsf/fr/publications/telechar/avis_r/avis-du-comite-consultatif-du-secteur-financier-renforcement-comparateurs-assurances-dommages-internet.pdf

265 For a copy of the template for initial disclosure, see ICOBS 4 Annex 1G: Initial disclosure document, available online: http://fshandbook.info/FS/docs/icobs/icobs4_annex1_20130401.pdf, updated April 2013.

5.5.2.1 Investment services and kick-backs

In **Spain**, for investment firms, article 3.4 RD 217/2008, allows information about inducements to be provided to clients (prior to the provision of the relevant service) in a summary form, provided that the entity undertakes to disclose further details at the request of the client and honours that undertaking.

In **Germany**, Section 31 of the Securities Trading Act (WPHG) states that investment companies shall avoid conflicts of interest and ensure that if these are unavoidable customers' orders are executed with due regard to customers' interests and disclosing their conflicts properly. In addition, according to section 31d para.1 Nr.2 of this act, investment companies shall disclose all kinds of remuneration, such as commissions, fees or other cash benefits or financial advantages received from parties other than the customer. The company has to disclose those remunerations in a way that makes the dependencies easy to understand, comprehensive and correct. Otherwise, according to section 31d paragraph 1, investment companies are not legally entitled to such remunerations. Only remunerations that are meant to increase the quality of the services for the customer are not contrary to section 31 paragraph 1 Nr. 1 of the German security trading act.

At the time of research, there are no court decisions with regard to section 31 d of the German security trading act. Nevertheless, the question of disclosure has been discussed by the German Federal Court of Justice (Bundesgerichtshof – BGH). In the year 2000 the 11th Senate of the *BGH* introduced its so-called “kickback” jurisprudence, stating that banks would have to disclose kickbacks (return of fees) they receive from financial service providers when recommending their financial products.

According to this jurisprudence, banks must compensate any damages caused by a wrong decision of the customer if they do not disclose kickbacks. This jurisprudence has been, and still is, heavily criticised by banks.²⁶⁶ In the *Kickback I* decision, the court did not mention *conflicts of interest* but *churning* and the *lack of trustworthiness* of banks and intermediaries. Conflicts of interest however are mentioned in the *Kickback II* decision, taking into account the idea of section 31 WPHG (Public Law) that ‘providers must try to avoid any conflict of interest or else, at least must disclose those conflicts’. The outcome of those decisions was varied.

The 11th Chamber ruled that banks have to disclose kickbacks deriving from fees and agios that they received from, or granted to the provider (*Kickback I*) of the financial services (irrespective of the amount of the kickback), but not from commissions (*Kickback V*). In nearly all of those cases, the legal solution was to order banks to compensate the damages. But some German High Courts do not follow the differentiation made by the 11th Chamber between “fees” and “commissions”. Further, the third Chamber continued to apply an old *threshold* ruling that commissions must only be disclosed if extraordinarily high (15% for brokerage of closed investment funds) and applied such ruling to brokers. This is because, according to the 3rd Chamber, customers would know that brokers earn money from providers when customers do not pay a fee or other kinds of remuneration themselves. To add to the complexity of this question, a number of other pieces of legislation apply to intermediation and its remuneration in Germany. This includes the Securities Trading Act (section 31), the decree on intermediation of financial assets

266 See as a good example Edelmann, BB 2010, 1163-1172.

(FinVermV)²⁶⁷ and codes of conduct as on the intermediation of financial assets (FinVermV, section 17), in effect since 1st January 2013. The legislation in place aims at disclosure of all kinds of remuneration granted by third parties. Despite legislation in place, it is unclear if intermediaries of financial assets are obliged to disclose kickbacks in the same way banks are.²⁶⁸

5.5.2.2 Insurance trading

Obligations to disclose information about the level of remuneration in insurance trading exist in legislation. For example, in **France** an obligation to disclose is imposed only in B2B relationship and at the request of the client by the insurance code.²⁶⁹ In **Poland**, it appears that the level of remuneration will be disclosed but at the request of the client also, although we are unclear whether this also includes consumers or remains limited to B2B transactions like in France.

By contrast, more developed transparency obligations were identified. Indeed, in **Spain** there is no general obligation to disclose the amount of the remuneration received by insurance intermediaries. However, brokers are under an obligation to disclose their commissions received from the insurers when the broker also receives fees from the clients in exchange of its services. It appears that the same situation exist in **Slovenia**.²⁷⁰ This creates discrepancies in the protection of consumers depending on the intermediary used.

In **Ireland**, the Consumer Protection Code (2012) applies to all entities regulated by the Central Bank including insurance intermediaries. The Code provides that where remuneration is to be received by a financial intermediary from a product producer on an on-going basis in respect of a product or service, the intermediary must disclose to the consumer on paper or on another durable medium, prior to the provision of that product or service, the nature of the service to be provided to the consumer in respect of this remuneration. Also, prior to the sale of a non-life insurance product, an insurance intermediary must: a) disclose in general terms to a consumer that it is paid for the service provided to the consumer by means of a remuneration arrangement with the product producer, b) inform the consumer of the amount of remuneration receivable in respect of that service or that details of remuneration are available on request, and c) disclose in general terms to a consumer any remuneration arrangements with product producers that are not directly attributed to the service provided to an individual consumer but are based on levels of business introduced by the intermediary to that product producer or that may be perceived as having the potential to create a conflict of interest. Further, where a financial intermediary allows the consumer the option to pay for its services by means of a fee, the option of payment by fee and the amount of the fee must be explained in advance to the consumer. Where the intermediary charges a fee and also receives commission in respect of the product or service provided to the consumer, it must explain to the consumer whether or not the commission will be offset against the fee,

267 This legislation applies to approximately 140,000 intermediaries. See Tiefensee, Kuhlen, GewArch 2013, p.17.

268 Tiefensee, Kuhlen, GewArch 2013, p.20.

269 Article R511-3 Insurance Code. Note however, that transparency obligations would likely be derived from civil law and consumer protection laws.

270 Indeed, in response to question C6 122, the respondent indicated: 'Art. 222 para 4 Insurance act provides, that an insurance broker - if he has a contract with the insurance company - must inform the client (insured person), inter alia about this fact and must reveal the amount of the commission or any other kind of payment that the broker may claim from the insurance company'.

either in part or in full. In addition the Life Assurance (Provision of Information) Regulations, 2001 provide for statutory disclosure of projected charges and intermediary remuneration to the client at the point of sale, in relation to most life assurance policies effected on or after 1st February 2001. This includes an illustrative Table of Intermediary Remuneration or Sales Remuneration²⁷¹ and the amount of the service fee (if any).

In the **UK**, similar provisions were found. The Life Assurance (Provision of Information) Regulations 2001 requires the disclosure of intermediary and sales remuneration. The intermediary must also disclose in general terms any remuneration arrangements with product producers that are based on levels of business introduced or that may be perceived as having the potential to create a conflict of interest. In the UK, the fees payable by a customer (or the basis on which they are calculated) must be disclosed before a customer incurs liability to pay the fee, or before conclusion of the contract, whichever is earlier according to ICOBS 4.3.1. Correct usage and timely provision of the Initial Disclosure Document (IDD) satisfies the obligation to provide this information.²⁷² There is specific provision for the disclosure "in cash terms" of any commission or "commission equivalent" to consumers in respect of sales of "pure protection products", i.e. insurance products associated with investment advice.²⁷³ There is otherwise no general requirement for insurance intermediaries proactively to disclose commission and no specific provision for disclosure of commission to 'consumers' under the ICOBS. This is by contrast to commission paid to an insurance broker or any associate. For those intermediaries, the commission must be disclosed promptly to commercial customers upon request (ICOBS 4.4.1).

Yet, there is no similar protection granted to consumers in the UK. Consumers have attempted to claim that non-disclosure of commission payable in respect of the sale of a PPI policy gives rise to an "unfair credit relationship" under s.140A of the Consumer Credit Act 1974. This claim was rejected in *Harrison v. Black Horse*.²⁷⁴ The commission in that case amounted to 87% of the premium. Tomlinson LJ for the Court of Appeal characterised the premium as 'quite startling' and acknowledged that 'there will be many who regard it as unacceptable conduct on the part of lending institutions to have profited in this way'. He nevertheless indicated that he would 'struggle to spell out of the mere size of the undisclosed commission an unfairness in the relationship between lender and borrower' [para 58]. The Court of Appeal held, in effect, that because the ICOBS rules did not require disclosure of commission then failure to disclose did not in itself result in an unfair credit relationship. The Supreme Court granted the Harrisons leave to appeal the Court of Appeal judgment in February 2012, but the appeal was then withdrawn in August 2012 before the Supreme Court heard any arguments.²⁷⁵

Similarly in **Germany**, the German legislator introduced some information duties for insurance companies in 2008, taking into account Directive 2002/83/EC of the European Parliament and of the Council of 5th November 2002 concerning life insurance. Those duties are provided in section 7 paragraph 1 German insurance contract act in conjunction with section 2 decree on information duties (dealing with life insurances) and section 3

271 i.e. the projected premium payable and the projected cost of total payments, benefits and services payable to insurance intermediaries or sales employees to cover intermediary remuneration or sales remuneration in connection with the policy in the policy year in question.

272 ICOBS 4.5.1G and see ICOBS 4 Annex 1G for the IDD.

273 ICOBS 4.6 and COBS 6.4.3.

274 2011 EWCA (Civ) 1128.

275 there is no indication that the Hurstanger case was cited or discussed in *Harrison v. Black Horse*."

(dealing with health insurances). According to those provisions, the insurer shall inform the policy holder in writing of his terms of contract, including details on costs included in the premium, showing the acquisition costs as a single amount and the other costs as a proportion of the annual premium, stating the period for which they apply in each case and details of other potential costs, particularly non-recurring or exceptional costs. The information should be given in good time before the policy holder submits his contractual acceptance. This information shall be provided clearly and comprehensively in keeping with the means of communication employed. According to the Court of appeal of Stuttgart (7 U 187/10) this information duty does not stretch to disclosure of a commission paid to an exclusive intermediary after the conclusion of a capital life insurance contract.

5.5.2.3 Loan brokerage

In **Germany**, loan brokerage is a contract under which an entrepreneur agrees for a fee to be paid by the consumer in order to broker a loan contract or financial assistance or to give the consumer evidence of an opportunity to enter into such a contract. In those cases, the loan broker must inform the consumer about the contractual details.²⁷⁶ The loan broker shall inform the consumer about the amount of the fee the consumer has to pay, whether he receives a remuneration from a third-party and if so its amount. The loan broker also has to inform the consumer about any additional payments that the consumer is due to pay. A loan brokerage contract with a consumer that does not satisfy those requirements prior to being entered into is deemed void (sec. 655b para. 2). The court of appeal in Frankfurt in 2011 (4 U 24/11) ruled that information duties extend to any remunerations received by additional or subcontracting loan brokers. In such cases the loan broker contracting with the consumer has to disclose all remunerations received by any broker in this 'chain of brokers'. It exempts only cases where such additional remuneration did not increase the price of the respective loan.

5.5.3 Transparency applied in practice

Transparency requirements are only as good as the paper they are written on. This section therefore looks into compliance and industry practice as well as experience of consumers.

5.5.3.1 Transparency practice in the Insurance industry

This section, based on the Bank of International Settlements' paper (BIS) on suitability of retail investments, illustrates some of the differences between financial sectors with regard to transparency and highlights the areas where insurance undertakings stand out. The 2008 BIS Report²⁷⁷ showed that only 60% of all firms (and 40% of insurance undertakings) consistently provided information on conflicts of interest and remuneration. Unfortunately it was not possible to have the breakdown by country. However the totals show that transparency is far from being optimal and suggests that enforcement of existing disclosure rules may be a problem.

276 This is according to section 655a German civil code in conjunction with article 247 section 13, paragraph 2 introductory act of the civil code.

277 BIS, Customer suitability in the retail sale of financial products and services, April 2008, at <http://www.bis.org/publ/joint20.htm>. This report considered how supervisors and regulated firms across the banking, securities and insurance sectors deal with the risks posed by mis-selling of retail financial products, including related regulatory requirements, both with regard to disclosure of information to retail investors and requirements on firms to determine whether recommended investment products are suitable for such investors. The countries covered by the study were: FR, DE, IT, NL, ES, UK, as well as Canada, US, Switzerland and Japan. Note that the report did not cover intermediation as such.

How does the insurance market fare with regards to information disclosure?²⁷⁸

Overall disclosure in the financial services of information items such as indirect costs and conflicts of interest is significantly weaker than the disclosure performance of other information items such as product characteristics. This was collected from responses of firms asked whether they were providing information to their customers on²⁷⁹:

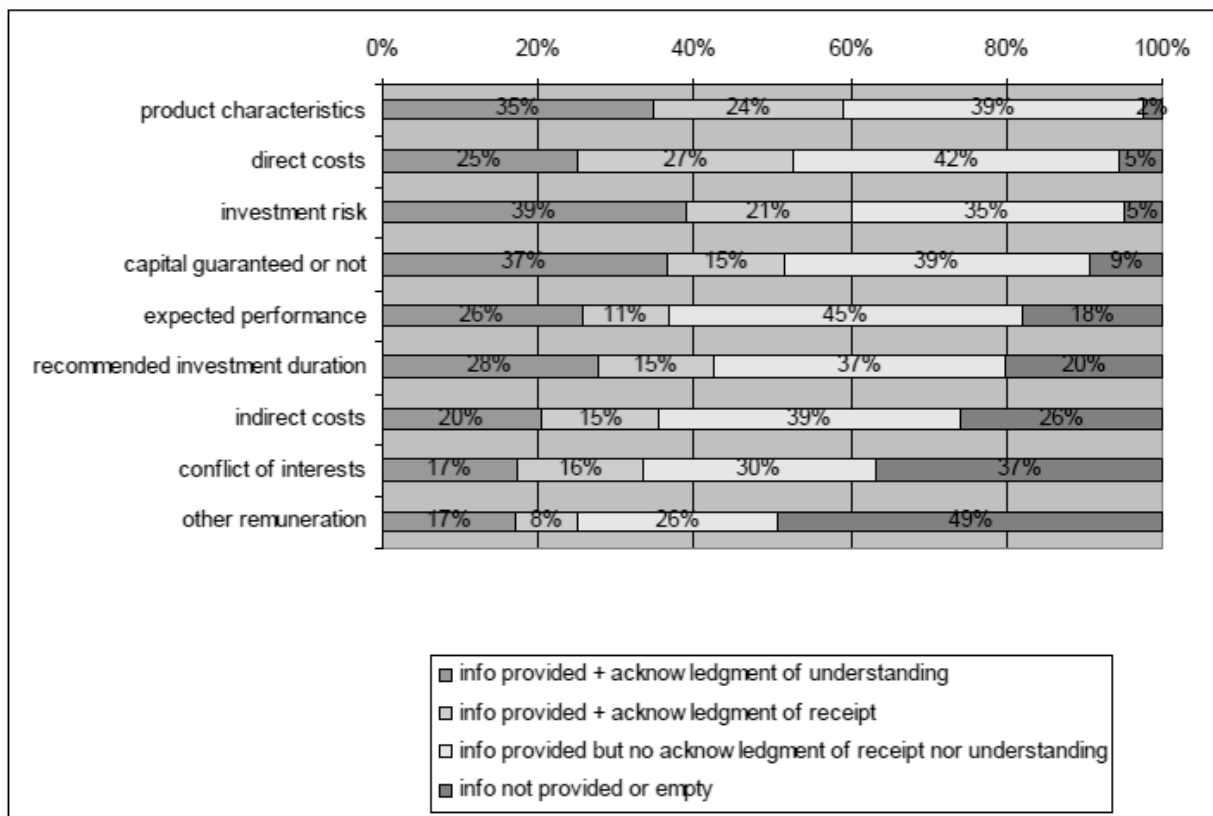
- Direct costs: the information on commissions, fees and other costs directly borne by the customer;
- Indirect costs: the information on embedded costs indirectly borne by the customer;
- Other remuneration: the amount and structure of other remuneration received by the firm for the sale; and
- Conflict of interests.

The Figure shows how product characteristics and direct costs are provided to consumers, most often and almost every time. While poorer record on systematic disclosure is noticeable with regards to expected performance of a product/policy and recommended duration, it is the information on conflicts of interest, or that have a bearing on them, that are the least often provided (See bars for "indirect costs" and "other remuneration").

278 The BIS definition of the term "disclosure" was: "any requirement that the firm disclose information to the retail client that could be material to the investment decision. In a sense, disclosure is intended to assist the retail client in making his/her decision, but is quite distinct from the requirement on a firm to make a determination of whether a particular product is suitable for the client". Likewise, the term "mis-selling" was used to generally refer to "the situation where the firm sells a product to a client that is not suitable for that client, whether or not a recommendation is made".

279 Other information types asked about as shown in the Figure were: a) product characteristics; b) whether the capital is guaranteed or not; c) the investment risk; d) the recommended investment duration; e) the expected performance or kind of events affecting performance.

Figure 37: Information provided to customers – comparison by category of information



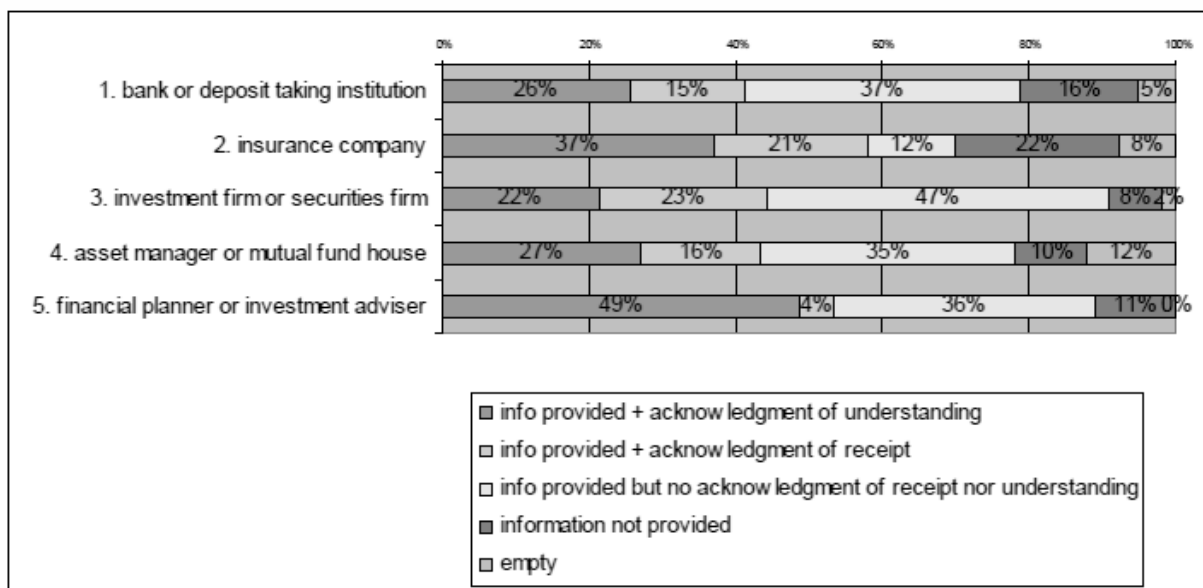
Source: BIS 2008 Report, p.48.

The BIS report notes:

“Differences between categories are at their maximum for indirect costs (...). These are provided by almost all investment firms and frequently by asset managers, but only provided by 60% of banks and insurance companies. The trend is similar concerning the disclosure of other remuneration received from third parties by the firm for the sale (...). As regards conflicts of interests, banks, investment firms and asset managers have a similar profile (disclosure by two thirds of them, with acknowledgment by one third), whereas only one third of insurance companies provide this information. However when they do so, they almost always require an acknowledgment of receipt or understanding.”

When looking at life insurance (or insurance policies generally), insurance companies offer less information than other firms. According to the BIS report, this is due to the fact that insurance companies sell an “in-house” product, with limited incidence of indirect costs, other remuneration and conflict of interests, whereas banks and investment firms that act as insurance intermediaries have to select an insurance provider that results in a more complex fee structure and greater potential for conflicts of interests. A sectorial analysis of the amount of information provided shows that out of all categories of information together, investment firms (90%) are providing the most information, followed by banks and asset managers, with insurance companies ranking last (at 70%).

Figure 38: Information provided to customers by categories of firms

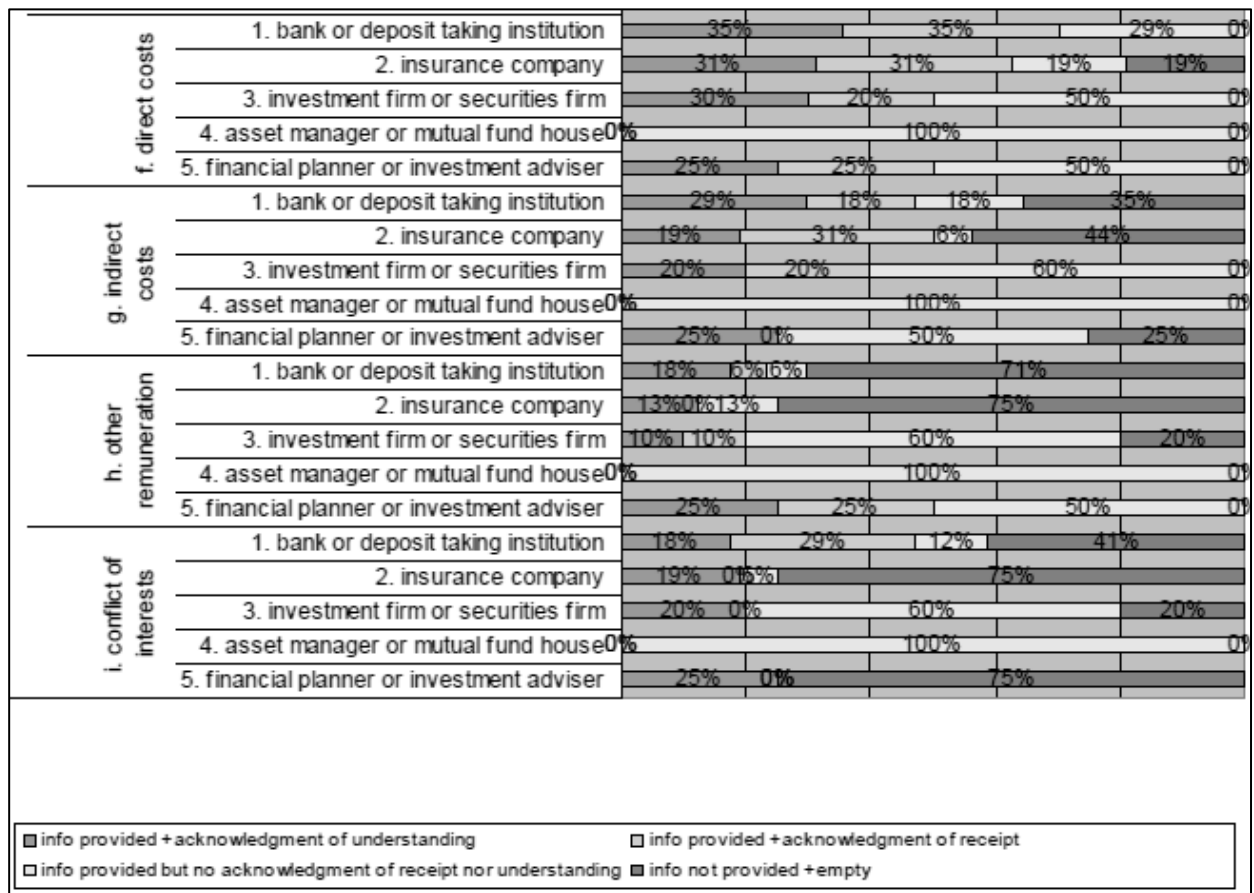


Source: BIS 2008 Report, p.49.

Specific disclosure of conflicts of interest and remuneration

In both the life and the non-life insurance market, the Figures shows that 75% of cases, insurance companies do not provide information to consumers about remuneration or conflicts of interest.

Figure 39: Non-life insurance - Information disclosure on costs, remuneration and conflicts of interest by firm type



Source: BIS 2008 Report, p.47.

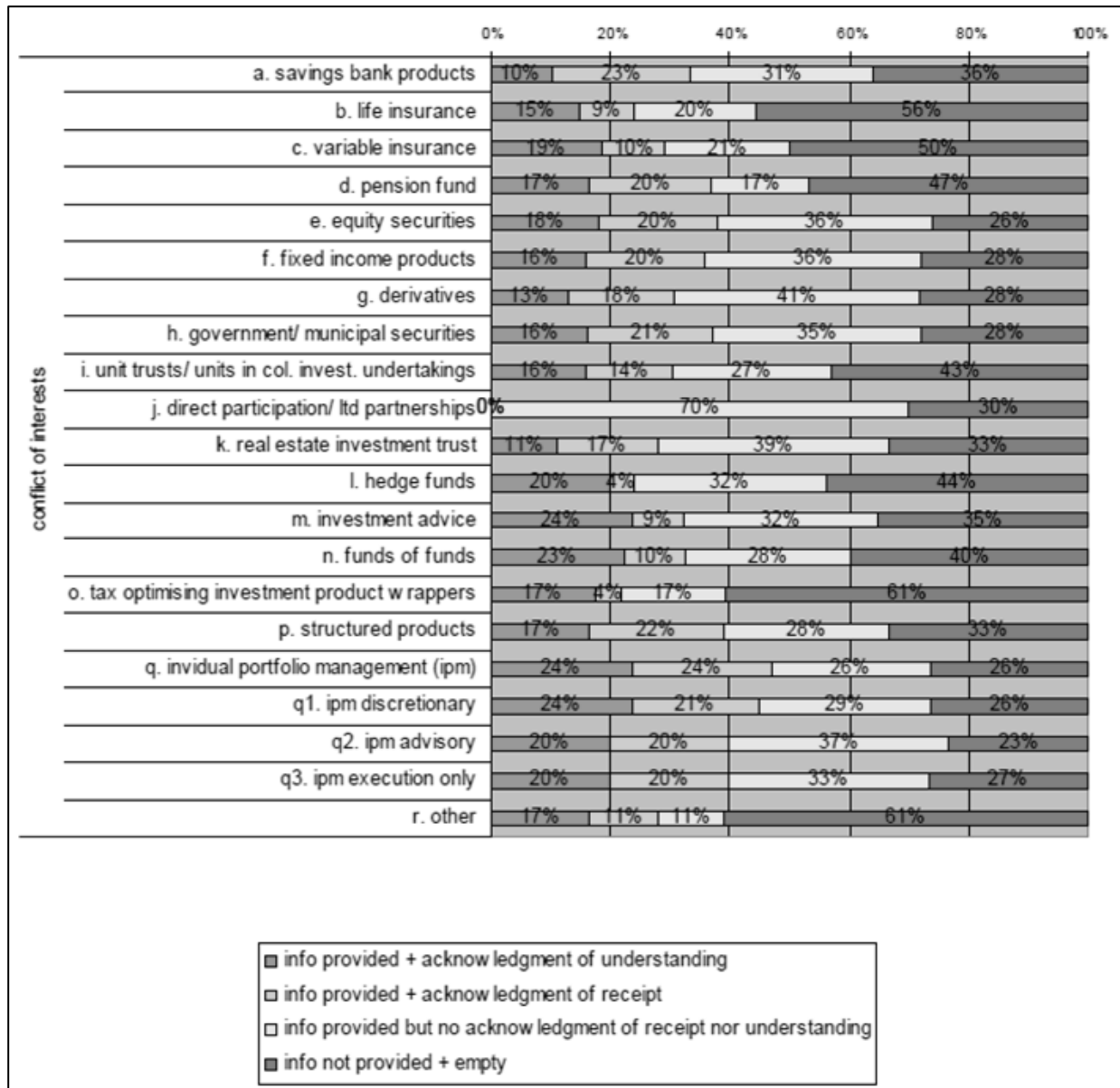
Figure 40: Life insurance - Information disclosure on costs, remuneration and conflicts of interest by firm type



Source: BIS 2008 Report, p.65.

The Figure shows that disclosure of conflicts of interest to consumers for life insurance products lags disclosure in all other product categories but one (tax wrappers). Over 50% of consumers are not being informed about conflicts of interests according to this data.

Figure 41: Disclosure of conflicts of interest by product class



Source: BIS 2008 Report.

Remuneration of sales staff

In the BIS report, firms were asked whether the amount of remuneration was independent from the product and whether remuneration was tied to compliance.

Insurance undertakings are in the middle, between financial planners and investment firms at the two extremes. The link between incentives and compliance of rules appears to be weakest for insurance undertakings alongside financial planners, with only 12% of them applying both measures. Insurance undertakings, however, do not stand out compared to other sectors when considering the total of firms, taking into account compliance in their incentive policy.

Figure 42: Remuneration of sales staff by category of firm

	Amount independent from product	Compensation is tied to compliance	Combination of both policy	Total of firms taking into account compliance in their incentive policy
bank or deposit taking institution	22%	9%	28%	59%
insurance company	18%	24%	12%	53%
investment firm or securities firm	11%	28%	17%	56%
asset managers or mutual funds	21%	0%	42%	63%
financial planner	25%	25%	0%	50%
Total	19%	14%	24%	58%

Source: BIS 2008 Report p.45. Note: the first column refers to only those firms applying exclusively a policy where the amount is independent from the product; the second column to firms in which the only policy is to tie remuneration to compliance; the third column includes firms combining both policies.

Other aspects of disclosure – form and timing

Another important factor in the assessment of the quality of disclosure is the actual timing at which information is provided. Timing is indeed relevant to best help the decision making process. Insurance undertakings in the sample do not set a good example in this respect either. In terms of the form of disclosure used by the different firms, the Figure shows that insurance undertakings provide comparatively little written information compared to their peers.

Figure 43: Form of disclosure by category of firm

	contract	regulated disclosure document	summary or other written information	oral discussion with the customer	other	form not specified
bank or deposit taking institution	24%	37%	47%	42%	0%	9%
insurance company	15%	59%	11%	27%	6%	10%
investment firm or securities firm	15%	57%	59%	50%	5%	10%
asset managers or mutual funds	22%	67%	39%	22%	20%	0%
financial planner	3%	78%	45%	35%	0%	0%
Total	20%	50%	46%	39%	5%	7%

In bold: the most frequent form of disclosure for each firm type.

Source: BIS 2008 Report.

The BIS report concludes with the following:

*"The survey results indicate that firms take their suitability and disclosure obligations seriously. Matters such as compliance, supervision and training of employees appear to be high priorities. In the insurance sector, however, we noted gaps in disclosure of conflicts, particularly around remuneration. Similarly, we believe regulators and firms across all sectors could improve rules and practices regarding how sales agents are remunerated. In other words, firms should consider the implementation of a remuneration system that rewards those who make substantial efforts to comply, and do comply with the highest suitability and disclosure standards."*²⁸⁰

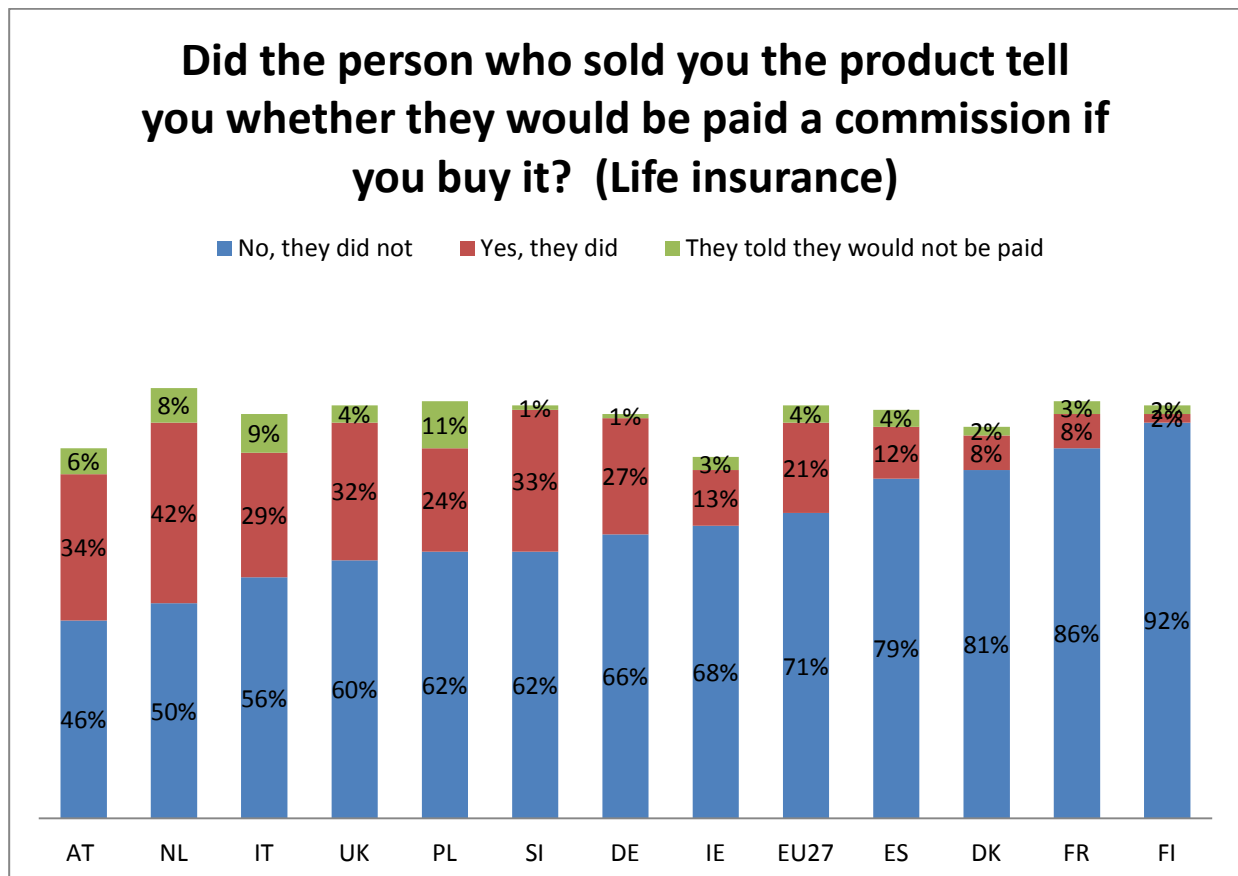
The BIS study results also suggest a number of measures to improve disclosure and information collection in practice, the second one being particularly worthy of notice for our current study:

- Collecting more information from customers regarding their investment strategy, including the risks involved in borrowing money to finance the purchase of investments (gearing strategy), and taking this into consideration before recommending a product to a retail customer.
- Seeking to address conflicts of interest by disclosure and other means. In this regard, mere independence of the compliance function may be insufficient by itself.
- Aligning the remuneration policy of sales agents and advisors with regulatory suitability and disclosure requirements, and related internal policies.

5.5.3.2 Disclosure of commission payments as self-reported by consumers

Another source, the European Commission's Eurobarometer survey, provides some information on the extent to which consumers recollected having been informed that commission would be earned upon the sale of the life insurance policy. Spain, Denmark, France and Finland performed above the EU average (71% of the time), as per the Figure.

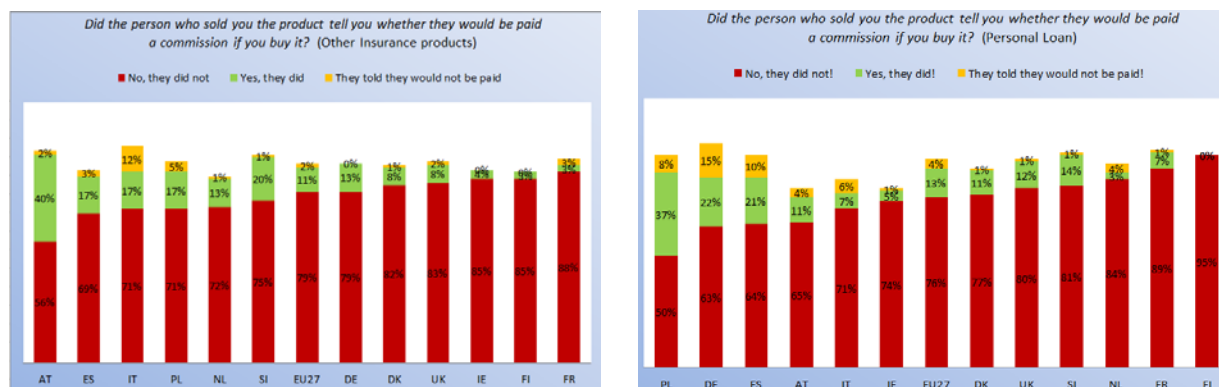
Figure 44: Share of consumers that have been informed by their adviser of commission they are being paid when sold life insurance



Source: European Commission, Special Eurobarometer 373, Retail Financial Services, 2012, p.58.

Interestingly, there seem to not be much difference in performance regarding provision of information on commission earning between the sale of life insurance, non-life insurance and credit products as the following two charts show.

Figure 45: Share of consumers that have been informed by their adviser of commission they are being paid when sold non-life insurance and credit



Source: European Commission, Special Eurobarometer 373, Retail Financial Services, 2012, p.56 and p.59.

5.5.4 Potential positive effects of transparency regulation

The report authored by Andreas Friberg and Magnus Listermar in association with Ernst & Young Advisory Services on the future of life insurance intermediaries looked at a prospective ban of commission in Sweden. The report was informed by the Danish and Finnish experiences of a ban. It concluded that while it is *'necessary to ensure that independent advice is truly independent and not undermined by the current commission model'*, a ban may come with several other unwanted features. In particular, the report points out that a *'commission ban may be a threat to efficient competition among intermediaries and insurers. Impaired competition and a decreased role of insurance intermediaries can have serious implications for the efficiency, pricing and development of the Swedish insurance industry. To avoid similar effects to those experienced in Denmark and Finland, it is questionable whether a commission ban is suitable for the Swedish market.'* The authors pointed to other solutions able to *'resolve much of the expressed concerns considering commissions'* which includes transparency and supervision.²⁸¹ One other solution proposed was the abolition of gross premiums, because *'the current gross premium model on the life insurance market hides the costs related to the brokerage services within the insurance product'*. The authors continue, *'to avoid misunderstandings between consumers and brokers, it is important to ensure that consumers do not think of the brokerage services as free. This can be accomplished by abolishing the gross premium model and at the same time imposing policies of conduct for the intermediaries to follow, in order to educate consumers about the market.'*²⁸²

Transparency overall can provide a viable solution to conflicts of interests and enable consumers to receive independent advice. Overall it can lead to more satisfactory results than a ban. This is because, information can help mitigate behavioural biases and avoid excluding access of the most vulnerable consumers to insurance products. Indeed, a ban on commissions, while solving one problem may create some others. First, there is evidence in the Finnish and Danish markets that the ban on commission can have an impact on competition, making market access more difficult for small players for example

281 Andreas Friberg and Magnus Listermar (In association with Ernst & Young Advisory Services), The future of life insurance intermediaries, 2011, concluding remarks, p. 24, available online: [http://www.ey.com/Publication/vwLUAssets/The_future_of_life_insurance_intermediaries_EY/\\$FILE/The%20ofuture%20of%20life%20insurance%20intermediaries%20E&Y%20-%20Friberg%20&%20Listermar.pdf](http://www.ey.com/Publication/vwLUAssets/The_future_of_life_insurance_intermediaries_EY/$FILE/The%20ofuture%20of%20life%20insurance%20intermediaries%20E&Y%20-%20Friberg%20&%20Listermar.pdf).

282 Andreas Friberg and Magnus Listermar (In association with Ernst & Young Advisory Services), The future of life insurance intermediaries, 2011, concluding remarks, p. 24, available online: [http://www.ey.com/Publication/vwLUAssets/The_future_of_life_insurance_intermediaries_EY/\\$FILE/The%20ofuture%20of%20life%20insurance%20intermediaries%20E&Y%20-%20Friberg%20&%20Listermar.pdf](http://www.ey.com/Publication/vwLUAssets/The_future_of_life_insurance_intermediaries_EY/$FILE/The%20ofuture%20of%20life%20insurance%20intermediaries%20E&Y%20-%20Friberg%20&%20Listermar.pdf).

and privileging large entities. Second, the paternalistic approach²⁸³ imposing a ban will mostly benefit consumers who may be most able to look after their interests, given the right information at an opportune time. Yet, the most vulnerable, for whom paternalism ought to be most desirable will be excluded, not being able to afford the fee that will need to be paid to truly 'independent' insurance intermediaries or other financial advisors. If commissions are banned, the poorest consumers, unable to pay a fee for the advice they receive risk being excluded from the market or end up with product even less fitted to their needs.

For transparency to work however, two main elements will need to be taken into consideration: the importance of the form and content of the disclosure and the 'independence of the intermediary'.

5.5.4.1 Independence of intermediaries

Independent intermediaries should be immune from conflicts of interest. Yet at European level there is no definition or clear understanding of what being independent mean and how much of a positive or negative impact it could have on dispensing good advice and selling good products to consumers.

In the **UK**, the notion of independent financial adviser (IFA) dates back to 1987 where a polar distinction was made between independent agents, able to advise on a range of products and tied agents limited to the product of one company.²⁸⁴ IFAs also were under an obligation to disclose their status to the consumer at the outset of the advice process in order for the consumer to be able to grasp the advice likely to be given and the range of products that will be part of the adviser's pool. Polarisation (the binary divide between independent and tied agents) created its own problems, with the majority of financial intermediary having chosen to be tied agent rather than independent. Depolarisation reforms followed in 2005. Agents could choose from 3 models: offer advice from the whole market, from a limited number of providers or from a single provider. Within the first category of agents, the intermediary could be an untied and commission based 'whole of the market' firm or an independent adviser advising on the whole of the market and offering a fee option. Thus, there was no ban of commission in place. And as long as the intermediary offered advice from the while market and gave consumers the option to pay a fee rather than the intermediary receives commission, those intermediaries could be called 'independent'. The most recent reform coming in the shape of the Retail Distribution review has changed this model once more. Financial advisers can now be called 'independent' only if the personal recommendations they offer to their clients are based on a comprehensive and fair analysis of the relevant market and are unbiased and unrestricted.²⁸⁵ However under the new regime, all are prohibited from receiving commissions and are requested to set charges. Independence therefore rests on the ability to advise from the whole market rather than a sample. In **Italy** by contrast, where the

283 On paternalism, see Ogus, the paradoxes of legal paternalism and how to resolve them, *Legal Studies* 2010. Paternalism shifts responsibility away from consumers. The law is used as an instrument to secure protection against whatever harm or loss may befall consumers, even when such harm occurs as a result of their own actions. For an overview of policy models in the financial industry, see Vanessa Mak, The myth of the 'empowered consumer': lessons from financial literacy studies, *Zeitschrift für Europäisches Unternehmens und Verbraucherrecht (euvr)* (2012) 4:254-263.

284 Riccardo De Caria, Regulating independent financial advisers: current trends and reform proposals, between the EU and the national level, *Federalismi.it, Revista di diritto publico italiano, comunitario e comparato*, February 2012, p. 4.

285 See COBS 6.2A and 3R.

regulation of independent advisers is rather recent, independent advisers are not allowed to receive remuneration from anyone but their client.

It is important to ensure as much independence as possible. However, a ban on commission may not necessarily be the only way to do so. Indeed, it may be acceptable to consumers to know that a commission is being received and have the option to pay fee or let the intermediary get the commission as long as the process and the options are transparent.

5.5.4.2 Forms and contents of disclosure

Transparency and an approach more based on trust²⁸⁶ that the consumer with adequate information will arrive at a desirable result, is recommended. Yet, information needs to happen in a way which is useful and comprehensible for the consumer if it has to have any positive effects. One element that is useful to consumers is the disclosure of the amount of commission as well as who pays and who receives it. Consumers want to know what the insurance product will cost to them. The advice necessary to make the right decisions for consumers needs to be dispensed at an opportune moment. It has to be part of the sale process and part of the offer.

5.5.4.3 Necessary safeguards

However, some safeguards needs to be put in place. This is because, with information often comes the assumption that consumers are able to process the information given and make sense of it. That is to say, the default setting is to assume that given adequate data, the consumer, rational economic agent²⁸⁷, will reach the adequate conclusion and choose the best product for his or her needs, be it a car or the insurance that has to come with it. Financial services products and insurance products, due to their complexity, require 'enhanced' information in order to put consumers on a level playing field with providers and resolve asymmetries. According to Willis, *'substantive regulation of contract terms or product or service attributes can create inefficiencies and can be a drag on innovation, both of which can hurt consumers. But giving consumers more information in today's information-saturated economy is not enough to assure good or even truly autonomous decision making. We may at times have to intervene in the market to create the conditions necessary for consumers to use disclosures to arrive at decisions that are efficient, autonomous, and good for them, their households, and their communities.'*²⁸⁸ Legislation, through transparency obligations attempts to provide the right tools. In fact, as explained in this report, legislation is in place in order to provide consumers with information. Those provisions are by and large adequate with regards to the content of the disclosure. Yet,

286 See Moloney, How to protect investors, Lessons from the EC and the UK. International corporate law and financial market regulation (2010), Cambridge University Press. The book explores why the retail investor should be protected, whether retail investor engagement with the markets should be encouraged and how investor protection laws should be designed, particularly in light of the financial crisis. The book considers the implications of the EC's investor protection rules 'on the books' but also considers investor protection law and policy 'in action', drawing on experience from the UK retail market and in particular the Financial Services Authority's extensive retail market activities, including the recent Retail Distribution Review and the Treating Customers Fairly strategy.

287 For a critique of how legislation takes this homo economicus into account, see for example (in the USA) Willis, Lauren E., Decision making and the Limits of Disclosure: The Problem of Predatory Lending: Price. Maryland Law Review, Vol. 65, p. 707, 2006; Loyola-LA Legal Studies Paper No. 2006-27. Available at SSRN: <http://ssrn.com/abstract=927756>. Note that 'although this article is focused on the problem of predatory home lending, it contains valuable lessons about when and how disclosure can realistically be used in legal regulation more generally'.

288 Willis, Lauren E., Decision making and the Limits of Disclosure: The Problem of Predatory Lending: Price. Maryland Law Review, Vol. 65, p. 707, 2006; Loyola-LA Legal Studies Paper No. 2006-27. Available at SSRN: <http://ssrn.com/abstract=927756>.

legislation does not systematically dictate the form of the disclosure, although some member states have adopted the use of templates.²⁸⁹

5.5.4.4 Form of disclosure

Yet, while the type of information provided is important, the form it takes is key. Indeed, form is as important as content. Some research from the Federal Trade Commission on mortgage broker compensations (remuneration), although a little dated, reveals that the disclosure of yield spread premiums paid to brokers raise concerns that the remuneration disclosure could confuse borrowers, draw attention toward broker remuneration rather than the cost of the loan, and lead to worse rather than better mortgage choices.²⁹⁰ One of the result, was that the *'remuneration disclosures had a significant adverse impact on the respondents' perception of loan costs and on respondents' choice of loans. The disclosures caused a significant proportion of respondents to choose more expensive loans by mistake and caused a substantial bias against broker loans even when the broker loans cost the same or less than direct lender loans.'*²⁹¹ Yet, despite those problems, linked mostly with the way the legislature had proposed to proceed with the disclosure of the information, the study also explained that transparency can be a more beneficial policy if it *'would focus on clear disclosure of mortgage costs, a clarification of the role of mortgage originators, and the encouragement and facilitation of borrower comparison shopping across originators.'*²⁹² Therefore, it is the form of the disclosure that seems to lead to the confusion and erroneous choices, and not the disclosure itself.

Transparency indeed continues to be a paradigm used, for example in the UK in the investment advice market under the Retail Distribution Review. The premise of the review was to improve the way advice was delivered. The *'RDR made clear how much consumers pay for financial advice, what they pay for, and improved professional standards by introducing a minimum level of qualification for all investment advisers.'*²⁹³

The findings of the July 2013 FCA review report accompanied by consumer research showed that more needed to be done in two main areas: firms needed to provide clients with some or all charges in cash terms (rather than percentages) and firms had to be clearer about what on-going services they will provide. Other points that needed to be changed included timing of information provision, independent firms not offering a truly independent service, restricted advice not being clear enough about how the firm was restricted.²⁹⁴

The consumer research conducted in tandem with this qualitative study clearly demonstrated the importance of firms providing clear information so clients understand the costs of advice and the service they can expect. The FCA review report looked at the

289 For example in the UK, for a copy of the template for initial disclosure, see ICBS 4 Annex 1G: Initial disclosure document, available online: http://fshandbook.info/FS/docs/icobs/icobs4_annex1_20130401.pdf, updated April 2013.

290 FTC, Bureau of Economics Staff Report, James M. Lacko and Janis K. Pappalardo, The effect of mortgage broker compensation disclosures on consumers and competition: a controlled experiment, executive summary February 2004, available online: <http://www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf>.

291 FTC, Bureau of Economics Staff Report, James M. Lacko and Janis K. Pappalardo, The effect of mortgage broker compensation disclosures on consumers and competition: a controlled experiment, February 2004, p.ES3, available online: <http://www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf>.

292 FTC, Bureau of Economics Staff Report, James M. Lacko and Janis K. Pappalardo, The effect of mortgage broker compensation disclosures on consumers and competition: a controlled experiment, February 2004, p.ES7, available online: <http://www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf>.

293 See <http://www.fca.org.uk/news/rdr-six-months-in>.

294 See <http://www.fca.org.uk/news/rdr-six-months-in>.

ways disclosure documents currently share critical information such as costs and scope of service, and the behavioural context behind the use of these disclosure documents. The findings are summarised below:

- Information can play a stronger role in establishing trust (existing forms do not always support consumer decision making when selecting an adviser. Current format and their presentation in a meeting does little to change participants' perceptions of how financial advice works);
- information can encourage consumers to take an active role in understanding the advice processes and costs;
- Charges are not understandable when not in cash terms. E.g. difficulties based around applying the costs from pricing structures based on percentages or hourly fees. In addition, while hourly rates are understandable as a format for pricing, they do not in themselves give any indication of how long it might take to arrange a solution for a consumer. Difficulties also include those with fixed fee models (which is often not about the price, but in knowing which service may be needed, and thus the price associated with that service) and lack of explanations on timing of fee payments for initial and on-going services;
- Restricted scope of service needs more context e.g. existence of an off-setting pricing where an initial fee charged irrespective of purchase or not, can then be recuperated as offset of the cost of this fee against later implementation fee in case of following through with recommendation.
- Behavioural context means that documents are viewed differently based on cultural framework (e.g. EU variations in attitudes should be researched and prejudice about advice should be taken into account), knowing about the process helps consumers feel trust and confidence.

Table 27: Feedback from consumers on pricing

Pricing	Suggested improvement from participant feedback
Percentage based	<i>Very clearly laid out pound examples – at useful price points – to ensure that people are equipped with a 'benchmark' for the costs of advice</i>
Hourly rates	<i>Ensuring that 'typical costs for an investment customer' or 'typical costs for a pension customer' are shown. Highlighting very clearly that a personalised quote will be provided before the customer is liable for any charges, highlighting that there will be a 'cap' on charges to ensure people feel protected against the fear of 'writing a blank cheque'</i>
Fixed fees	<i>Absolute clarity of which fixed fee service is suitable for an individual's needs</i>

Source: NMG Consulting July 2013 p.11.

The research also pointed out that identifying charges appears straightforward on the surface but the details are very important.²⁹⁵

What the FCA review indicates is that it is possible to deliver transparent advice to consumer (content and form), but that implementation and monitoring of the way firms adapt to the new rules remains key. Supervision is therefore a corollary to transparency. In addition, the review confirms the role all stakeholders can play in the transition from commission-based model of remuneration to the fee-based model e.g. by purposeful public education campaigns.²⁹⁶

²⁹⁵ See Annex for examples of better disclosure on pricing as highlighted by NMG consulting report July 2013, e.g. for presenting the various costs, choice of fee options, and benchmark for hourly rates.

²⁹⁶ The review shows that in the UK people still hold the belief about paying for advice whereby they think that commission still exists or that one pays when one buys. Also very few consumers know the difference

5.5.4.5 Supervision as a corollary to transparency

It is clear from our survey that at present, some of the consumer detriment may result from current transparency obligations not being adequately respected rather than because transparency, as a method in itself, is necessarily inefficient. Indeed, the data gathered from respondents to the surveys shows that transparency obligations do exist in the member states studied. What is lacking however, it seems, is adequate disclosure of the information to consumers (data from the BIS²⁹⁷, illustrated how widespread lack of information can be) as well as sufficient enforcement mechanisms to avoid consumers being mis-sold. Better avenues for solving conflicts of interest may therefore look at what would make disclosure workable for consumers in the EU. In particular, the need to disclose who pays the commission owed to the intermediary. This could be via a model disclosure form developed through empirical research.

5.6 Early cancellation

The remuneration structures of the insurance intermediaries often include payment of commission from the outset. The survey inventoried legal provisions dealing with cases of early termination of the policy. It transpired that this is an issue that is still mostly dealt with by contract law. This was the case for example in **Spain, Denmark, France, Italy** and **Poland**.

However, some member states have adopted provisions dealing more specifically with those issues in the absence of contractual agreements.

In **Germany**, under the German Commercial code, sec. 87 ff., in the absence of a special agreement between the parties, or any local custom to the contrary, the mercantile brokers' remuneration must be paid in equal shares by both parties. In practice the insurer calculates the brokerage and integrates it into the distribution costs in the premium calculation. Similarly, insurance agents and insurance companies may agree upon the modalities of the commission claim, as for example the height, the time of the forming and the payment. In cases where insurance premiums are due in instalments, the contractors may agree to the agent receiving his commission after the entire payment of the first annual premium. However, it is usually agreed to that the insurance agent receives an advance payment. In the case of an early cancellation, the advance fee is to be paid back proportionately, as far as the agent has not yet earned the commission, at the time of the early cancellation. According to section 87a of the German commercial code, insurance agents (if nothing else is agreed upon) are entitled to a commission upon every transaction entered upon which has been brought about by his agency. If a transaction remains wholly or partially incomplete, owed to the conduct of the insurance company, unless the character of the person with whom the transaction was made furnishes cogent grounds for such conduct, the full amount of commission may be claimed by the agent.

With regard to life insurance and substitute of insurance, the act on the supervision of insurance undertakings (VAG) provides for the calculation and distribution of the already paid for commission amongst the consumer and the provider. According to sec. 80 par. 5 VAG insurance undertakings are required to ensure that in cases of early termination of the contract, the already paid initial commission shall be refunded to the policyholder, pro

between independent and restricted advice and many believe that all advisers (excepting bank employees) are independent, likewise 'restricted' is understood to equate to the pre-RDR concept of tied (i.e. a single provider) and there is no understanding of the continuum of advice options that exists between a very narrow restricted arrangement and independent financial advice.

297 BIS, Customer suitability in the retail sale of financial products and services, April 2008, at <http://www.bis.org/publ/joint20.htm>.

rata temporis. The insured person should pay no more than the share of the commission for the time the contract had been in effect providing that the total commission is distributed evenly within the first five years.

This is a method that is also used in **Italy** where insurance contracts and mediation contracts connected to consumer credit agreements are subject to a pro rata duty of restitution according to the rules agreed between the Bank of Italy and IVASS. This is a position confirmed by case law. In particular, see Arbitro Bancario Finanziario which obliges to the restitution on the criterion of *pro-rata temporis*.²⁹⁸ Further in Italy, agency contracts provide for a partial restitution of the remuneration in terms of commissions paid if the client revoke his consent or the contract is subject to an early termination. The same rule is provided for brokers in the cooperation letters signed between the broker and the company.²⁹⁹

We also found provisions concerning length of contract and termination in **Finland** and in **Slovenia**. In this latter country, Art. 823 para. 4 of the Obligations Act states that an agent has a right to commission even after termination, if the contract between the client and the insurance company was concluded because of his efforts. Art. 833 regulates severance pay. An agent is entitled to claim it, if he has acquired new clients within a year upon termination (art. 835 para. 2).

Conversely, in the **UK**, the law offers a cooling off period. ICOBS 7 sets out the cooling-off cancellation rights and the consequences of cancellation. It provides also that when a firm provides longer or additional cancellation rights the contractual terms should be no less favourable than the regulatory provision 'unless the differences are clearly explained' (ICOBS 7.1.2G). The exceptions to the right to cancel are set out in ICOBS 7.1.3. ICOBS 7.2 provides that in the event of cancellation within the cooling off period, the consumer may only be required to pay, without any undue delay, for the service actually provided by the firm in accordance with the contract. The amount payable must not: (a) exceed an amount which is in proportion to the extent of the service already provided in comparison with the full coverage of the contract, and (b) in any case be such that it could be construed as a penalty. A firm must not require a consumer to pay any amount: (a) unless it can prove that the consumer was duly informed about the amount payable, or (b) if it commenced the performance of the contract before the expiry of the cancellation period without the consumer's prior request. A consumer cannot be required to pay any amount when exercising the right to cancel a pure protection contract. A consumer cannot be required to pay any amount when exercising the right to cancel a payment protection contract unless a claim is made during the cancellation period and settlement terms are subsequently agreed. On cancellation, according to section 7.2.6, a firm must, without any undue delay and no later than within 30 days, return to a consumer any sums it has received from him in accordance with the contract, except as specified in this section. This period shall begin from the day on which the firm receives the notification of cancellation.

5.7 Enforcement

A number of provisions destined to control remunerations in the insurance industry and more broadly financial services are in operation. One key aspect of the efficiency of such

298 see annex ABF decision 1389/2013.

299 According to our respondent, in strict legal terms, these are not contracts but letter of intents, which set principles of the cooperation between the company and the broker (or the agent acting in the name of the company and the broker), provided that no obligation can arise on the side of the broker in favour of the company.

controls rests with the more or less exacting ways they are enforced. Enforcement can have its origin in public enforcement, private action of consumers or competitors as well as collective/ representative actions of consumer associations or trade associations. Across the member states, a variety of enforcement methods apply, all depending on national preferences.

5.7.1 Role of public authorities in the enforcement of remuneration regulation

By and large, the member states in our study possess public enforcement mechanisms, although the depth and efficiency of their control could sometimes be called into question.

All member states appeared to have authorities able to impose some fine or other sanctions of an administrative or criminal nature. This is indeed the case in **Finland, France, Ireland, Italy, Poland, Slovenia, Germany**³⁰⁰ and the **UK** as well as the member states featured below. The types of sanctions observed in our survey tended to include fines, suspension of restriction to do business, withdrawal of licenses or prohibitions to exercise a profession.

In the **UK** for example, under part XIV of the Financial Services and Markets Act 2000, the regulator may take a variety of disciplinary measures in response to breach of the regulatory rules and Principles. Such measures include public censure, financial penalties, suspension or restriction of permission to undertake regulated activities, or restrict the permissible activities of an authorised person.³⁰¹ The regulator also may impose a prohibition order under s.56 on someone whose conduct shows is not a fit and proper person to carry out regulated activities.³⁰²

Some Member States also see public enforcement shared amongst a number of regulatory entities, sometimes presenting challenges of competence and overlaps.³⁰³ Conversely in **Denmark**, the Danish FSA (Finanstilsynet) supervises compliance.³⁰⁴ The Danish Financial Council assist in supervisory matters with powers vested in the Council pursuant to art.345(2) of the Financial Business Act. The Consumer Ombudsman participates in the Council's consideration of these matters and has the same powers as the Council members. In some parts of the legislation the Ombudsman has his own powers. It is only the financial undertaking, which may be a party in a case being dealt with by the FSA. Customers in financial institutions will not be parties in relation to the FSA.³⁰⁵ Art.344

300 In Germany, The law knows some administrative offences for an intermediary that violates his duty to inform the customer about his status. See for example, sec. 26 decree on the intermediation of financial assets (FinVermVO). There is a similar provision in sec. 18 (1) decree on the intermediation of insurances (VersVermVO).

301 Respectively, under Sections 205, 206, and 206A.

302 For an example of a recent case of a prohibition order and fine being levied on an insurance broker for insurance fraud, see Andrew Jeffery and the Financial Conduct Authority, Upper tribunal, Tax and Chancery Chamber, Reference number: FS/2010/0039, available at: http://www.tribunals.gov.uk/financeandtax/Documents/decisions/Jeffery_v_fca.pdf. Mr Jeffrey was disputing a decision by the FSA (1) To impose on Mr Jeffery a financial penalty of £150,000 for breaches of Statements of Principle 1 and 4 of the Authority's Statements of Principle and Code of Conduct for Approved Persons ("Statements of Principle") in the period between 14 January 2005 and 23 October 2009 ("the relevant period") pursuant to s 66 of the Financial Services and Markets Act 2000 ("FSMA"); and (2) To make a prohibition order, pursuant to s 56 FSMA, to prevent Mr Jeffery from carrying out any function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm. This sanction was confirmed and maintained by the Tribunal.

303 This was for example most notable in Spain, Poland, Italy.

304 See in general art. 344(1) of the Financial Business Act and for specific competence concerning insurance intermediaries, art. 44(1) of the Insurance Intermediation Act.

305 According to see art. 355(1) e.c.

constitutes the general basis for the FSA to issue orders and to give reprimands for violations of the law. If a financial undertaking does not comply with an order, fines may be imposed.³⁰⁶ The breach of certain provision is directly punished with fines and some offences may be subject to criminal penalty under the Criminal Act part 5.³⁰⁷

In **Spain**, a number of authorities also have powers to enforce legislation. The CNMV and DGSFP have disciplinary powers in respect of, respectively, financial investment firms and insurance intermediaries. Sanctions for very serious infringements, like revocation of licence are imposed by the Ministry of Economy and Competitiveness. Regarding insurance intermediaries it must be noted that Regional Governments (Comunidades Autónomas") have execution powers of the insurance mediation legislation (which is "basic" legislation in the whole Spanish territory). Those include full disciplinary powers in respect of those insurance intermediaries whose territorial scope is limited to the territory of that region. For insurance intermediaries very serious infringements would be constituted by repeated acts contrary to the insurance mediation legislation or inaccurate information provided to policyholders, insured parties or beneficiaries of insurance contracts (when this is relevant given the number of affected individuals or the relevance of the information). Other infringements sanctioned by public enforcement include the repeated infringement of the prior information obligations by insurance brokers, when the breach is of particular relevance as well as the repeated lack of independence of insurance brokers. Sanctions against brokers may consist in the cancellation of the intermediaries' registration or fines ranging from 15,001 to 30,000 euro. Further, activities contrary to the insurance mediation legislation can attract sanctions such as the suspension of an authorisation for a maximum up to one year or fines ranging from 6,001 to 15,000 euros. Note that similar sanctions are available for investment firms, although the scale of the fines is much higher. Indeed, a number of very serious infringements such as the lack of policies for handling conflicts of interest or failure to apply them, (other than on an occasional or isolated basis)³⁰⁸ could be sanctioned with the withdrawal of the authorisation and/or a fine of up to the highest of: (i) five times the gross profit obtained as a result of the infringement, (ii) 5% of the investment firm's own funds, (iii) 5% of the funds used in the infringement or (iii) 600,000 euro.³⁰⁹ Similarly, a breach of the obligation to act with diligence and transparency (which is breached when remuneration is not in accordance with regulations implementing the SMA) or the receipt by providers of investment services of commissions exceeding the limits established, if any, or without having complied with the requirement of prior publication and notification of the tariffs, where this is mandatory can lead to serious sanctions. Sanctions may imply, among other sanctions, a fine of up to the highest of (i) twice the gross profit obtained as a result of the infringement, (ii) 2% of the investment firm's own funds (iii) 2% of the funds used in the infringement or (iv) 300,000 euro (article 103 SMA).

5.7.2 Actions by Consumers and consumer organisations

For consumers it is on the basis of contract or tort law that they are most often entitled to bring private actions. Some member states also enable consumer association to proceed with representative actions on the same basis or to provide assistance to consumers.

306 See art. 373(3).

307 See i.e. art. 373(5).

308 article 99 z bis SMA.

309 Article 102 SMA.

Class actions are not available and consumer associations are often confined to putting pressure on insurance intermediaries and providers via means other than judicial redress. Indeed, a large number of respondents mentioned assistance³¹⁰ as well as publicity for bad practices.³¹¹

However in **Germany**, it is possible for consumer associations that are representative, to obtain injunctive relief for unfair commercial practices.³¹² Similarly in **Spain**, consumer associations that have the required standing can undertake actions for unfair terms and other issues. In Italy, it is possible for consumer associations to represent consumers in front of the national authorities or courts or start class actions. It seems however that powers granted to consumer associations to act on behalf of consumers or to defend the consumer interest in the area of insurance intermediation and more generally financial services is limited overall and across the member states studied.

One possible exception is the **UK**. Indeed, section 234C of the Financial Services and Markets Act 2000³¹³ makes provision for a designated consumer body to complain to the FCA 'that a feature, or combination of features, of a market in the United Kingdom for financial services is, or appears to be, significantly damaging the interests of consumers.' The FCA issued guidance on the use of super complaints³¹⁴ and is aimed at helping 'designated consumer bodies make comprehensive and robust complaints so that the FCA can respond in a manner that addresses a complainant's concerns most appropriately'. This process was modelled on the equivalent procedure in section 11 of the Enterprise Act 2000. It is this original procedure that was the basis for the super-complaint by Citizens Advice about PPI. The PPI super-complaint to the OFT³¹⁵ resulted in an inquiry by the Competition Commission and remedies, such as the ban on point of sale marketing of PPI.³¹⁶

We also located a number of cases brought by individual consumers especially in **Germany** and the **UK**, but by and large, consumers seem to have access to complaint boards, more efficient to deal with consumer disputes in this field.

This is particularly true in Scandinavian countries where such schemes are popular. For example in **Finland**, disputes may be solved by the Finnish Financial Ombudsman Service (FINE) or under the Insurance Complaints Board (working under the supervision of FINE). In addition, there is also the Consumer Disputes Board that consumers can use to settle disputes. Similarly, in **Denmark**, nearly all financial undertaking uses its own approved complaint board. Those include the Complaint Board for Banking Services (Pengeinstitutankenævnet), the Mortgage Credit Complaint Board (Realkreditankenævnet), the Insurance Complaint Board (Ankenævnet for forsikring), the

310 This included France, Italy.

311 See for example Ireland.

312 See the law against unfair competition ("Gesetz gegen den unlauteren Wettbewerb, UWG") which entitles such organisations to file claims in the interest of all consumers, as far as unfair business practises are concerned (sec. 1, 4 in conj. with 8 (3) Nr. 3 UWG).

313 Inserted by s.43 of the Financial Services Act 2012.

314 Published on June 25, 2013, available at: <http://www.fca.org.uk/your-fca/documents/finalised-guidance/fg13-01-designated-consumer-bodies>.

315 For more details on this super-complaint, see: <http://www.ofc.gov.uk/OFTwork/markets-work/super-complaints/insurance#.Ue5cmGxwblU>.

316 For more on the investigation by the Competition commission and results, see: <http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ppi-market-investigation-and-remittal>. See in particular, the final order, dated 21 November 2011, http://www.competition-commission.org.uk/assets/competitioncommission/docs/2011/disclosures/ppi_order.pdf.

Complaint Board of Investment Associations (Ankenævnet for investeringsforeninger) and the Complaint Board of Stock Broker Companies (Ankenævnet for fondsmæglerselskaber). The complaint boards are private entities authorized to operate by the Danish Minister for Business and Growth. Complaints may concern any legal issues arising from the relation between the customer and the company. However, the dispute must concern an issue relating to the law of property and obligations, which means that it has to be of a financial nature. Complaints regarding solely ethical issues are outside the scope of competence of those boards. As a main rule the complaint board will only consider complaints concerning private individuals (consumers). Nor does it handle issues which have been settled by a final judgment, validly binding arbitration or court settlement, or issues regarding criminal proceedings. But court settlement is a possibility since a party can go to court, if he or she is not satisfied with the result from the complaint board.

However, culturally not all member states surveyed made as much use of complaint boards or equivalent bodies. It seems other Member states have adopted a mixed approach where consumers use both courts and complaint boards. However, in **France**, it appears that consumers are more likely to go to court and courts have taken a rather harsh stance on businesses. In **Italy**, the authority is not able to adopt civil sanctions and therefore the courts seem to be the main avenue for redress.³¹⁷ After a brief spell where mediation was opened as an avenue for dispute resolution, it has been deserted following a decision from the Constitutional Court in 2012 declaring that Mediation was not compulsory. Courts do take between 3 to 4 years to reach decisions.

In **Ireland**, it is a mixture of both courts and the Financial Services Ombudsman that hear disputes. In the UK, Individual consumers may go to court, and indeed there have been a few cases, but by and large, consumers complain to the Financial Ombudsman Service about breaches of the regulatory rules and principles. In 2012/13 the FOS handled 2,161,439 initial enquiries and complaints, opened 508,881 new files, resolved 198,897 cases through more informal means such as mediation, recommended settlements and adjudications and 24,332 cases by formal decision of an ombudsman. Most FOS cases are resolved within 6 months (66% in 2012, 70% in 2011).

5.7.3 Professional bodies' role in enforcement

A number of professional bodies use ethical rules and can take action against members violating the rules set. For example, in **Denmark** there are a number of sectorial organisations such as the insurance agents' interest organisation for Insurance and Pension called 'Forsikring og Pension' and the Insurance Brokers' Association called 'Forsikringsmæglerforeningen'.³¹⁸ Equivalent bodies and ethical rules exist in **Finland**, **Italy** as well as in **Ireland**. Note however that in Ireland, sectorial codes seem to be superseded by the code of practice run by the Central Bank. While details were lacking in the response from the survey, it appears that such schemes, often voluntary, may lack the necessary bite in order to protect consumers and markets efficiently.

317 It appears to be the case in Poland as well, although there is a Polish Insurance Ombudsman available.

318 In addition to the Insurance Intermediation Act, the Insurance Brokers' Association has issued ethical guidelines, which applies to its members. The purpose of the guidelines is to ensure that the impartiality of brokers is not questioned, under any circumstances. The guidelines can be found in national language only, at: <http://www.fmf.dk/fmfs-etiske-regler%20>."

5.7.4 Providers and other intermediaries (competition law claims)

Very little information is available on the role intermediaries may play in enforcing remuneration regulation in the member states surveyed. In **Germany**, consumer associations as well as competitors are entitled to act to stop practices amounting to unfair competition. Similarly in **Spain**, under the Unfair Competition Act (Act 3/1991 of 10 January), certain acts carried, such as illegal advertising which could include misleading or untrue information about the remuneration of a financial intermediary, can be considered as unfair competition. In these cases, competitors may bring actions to stop the litigious practices as well as prohibit them for the future and to claim for the damages suffered as a consequence. In **Poland**, competitors can also submit claims to the court on the ground of unfair competition and inform the national bodies (KNF and UOKiK) about the irregularities for action to be taken if necessary. In **Ireland**, the Competition Commission is also able to intervene and take action if it believes that providers and intermediaries are engaged in anti-competitive conduct.

5.7.5 Self-regulatory efforts

Uni Finance Global Union, the multilateral trade union for employees of banking and insurance industries (representing 237 trade unions and 3 million workers worldwide) adopted a model charter on Responsible Sales of Financial Products on 9 June 2010 in Copenhagen which contained the following objectives and principles. European financial institutions should disclose the progress they have made in meeting these standards that emphasise "Sales versus Advice". It is unclear what progress has been achieved to date and examples, such as Barclays that have publicly reported positive feedback to these principles, is not enough if we are to expect self-regulating codes of conduct to produce the necessary change in culture that is necessary if the financial sector is to live up to its responsibility and promise to support the real economy and to deliver on their statement that good advice is the precondition for sustainable and long-term business success.

"A company's internal operating practices must be conducive to this [good advice and excellent customer service] and empower employees to act in a way that supports sustainable development. This includes appropriate remuneration and incentive systems, training of staff, good working conditions and a reasonable workload. We need a sustainable, customer-oriented finance sector, where sales of products are customer lead and always accompanied by proper advice."³¹⁹

The objectives are to ensure:

- internal business culture and operating procedures conducive to responsible sales of products;
- staff are empowered with a high level of professional competence and have a good work environment;
- financial products are of a high quality, suitable for the customer and are sold in a transparent manner; and
- continuous dialogue on sales and advice issues between the company, its employees and the trade union representing them as well as other stakeholders.

Of the 13 principles on responsible sales of financial products, some are linked to qualification and training³²⁰, some to trade union involvement³²¹ or wider consumer

319 UNI Finance Global Union, "Model Charter on Responsible Sales of Financial Products", adopted on 9 June 2010 in Copenhagen.

320 E.g. "j) To ensure that products are only sold by staff who are authorised, properly trained and have a thorough understanding of the products including their long-term implications for customers".

education³²², whereas others directly concern transparency of conflict of interest³²³, business culture³²⁴ and specific incentive structures³²⁵.

In terms of implementation and monitoring, the charter says: “f) [Name of company] should establish an internal structure allowing employees to report inappropriate internal practices to an internal, independent ombudsman in a manner agreed with the trade union side.... h) The work with the charter as well as measures of implementation will be made public”.

Lastly, the Charter mentions that consumer associations could be involved in elaborating better practice; however, we are not aware of their involvement in such initiatives to date.³²⁶ This is in contrast to reports from trade unions that show that employees of banks and insurance undertakings are often and increasingly under pressure, not only in their daily work but also because of the current economic context in the financial sector that can be used as a threat of being laid off if sales performance is weak. A separate dedicated research with the cooperation of the financial institutions would be necessary to find out the details of existing good and bad practice, however the sector is generally making changes to corporate governance and motivation schemes that move towards more responsible and sustainable employee remuneration³²⁷.

5.8 Regulation and experiences of stakeholders³²⁸

5.8.1 Suitability of regulation to alleviate remuneration problems

The use of Regulation (i.e. legislation or other measures) is likely to help establish better controls on remuneration. Indeed, the sample of respondents consulted including brokers, trade associations on the supply side, national authorities, legal experts and consumer associations seemed to agree about the potential of regulation. While the below is not meant to be interpreted as representative, there is sufficient anecdotal evidence to infer support for regulation. Remuneration has many advantages that were noted by respondents.

321 E.g. “g) To ensure targets are reasonable and achievable and remuneration is determined through negotiation with trade union representatives. The approach to individual employees must be in line with the collective agreement”.

322 E.g. “m) To contribute to financial education”.

323 E.g. “b) To ensure that incentive systems for employees at all levels are realistic, fair and transparent; based on long-term and sustainable goals; and do not damage employees” or “c) To ensure that conflicts of interests, roles and responsibilities of employees are always clear in a sales situation”.

324 E.g. “i) To stimulate a management culture based on trust, motivation and teamwork -not control, sales pressure and individual ranking” or “l) To ensure a continuous dialogue on responsible sales of products between the company, its employees and trade union representatives”.

325 E.g. “f) To apply incentive structures which reward good customer services and qualified advice. For instance, no sales targets for specific products” or “e) To ensure a fixed monthly income that allows the working individual a decent life” (to make sure that the incentives of increasing income via the variable portion of ones total income does not become a necessity).

326 “The charter should be formulated and agreed between top management and trade unions. It may also involve other stakeholders such as consumer associations”

327 See section 2.5 of the report containing a short summary of a UK study by Which? on bank staff pressure and remuneration.

328 The views and experiences gathered from stakeholders were concerned within the context of a questionnaire that specifically targeted questions to the retail insurance market, however, because these fields were open questions about financial intermediaries generally, these views may often be applicable to intermediaries generally. Where intermediaries for credit or investments were referred to, we have specified this.

Respondents were overwhelmingly in favour of seeing regulation introduced to mitigate the potential conflicts of interest and impartial advice. They supported the legislator, either European (40%) or national (40%) to introduce legislation rather than rely on self-commitment (6%) or other means (8%) for example. However, 6% of respondent preferred that no rules be introduced.³²⁹

The perceived suitability of policy measures in this area and the preferences in terms of who should be implementing these rules varies.

When asked if Remuneration Regulation (RR) could alleviate problems with intermediation of financial services, respondents' answers varied between very suitable to unsuitable.³³⁰ For instance 53% believe that RR is very suitable and will improve some of the problems with financial service intermediation (e.g. DK, FI, FR, IE, IT, PL, NL, SI). The rest 47% assume that the introduction of RR is either somewhat suitable or not suitable as a policy for reducing mis-selling and consumer problems in the retail insurance market (e.g. FR, IT, AT, DE, PL).³³¹

The introduction of remuneration regulation was deemed very suitable, by consumer associations in Slovenia, Poland, France and the Netherlands. This was because such regulation can *'introduce sanctions and supervision system, as well as remuneration for clients'* and because *'transparency can take away the incentive to go for the product with the highest commission instead of the best product for the consumer'*. The Slovenian consumer association commented: *'Many problems arise out of unclear legislation that allows for various interpretations. Clear and unified regulation across Europe would provide for a higher level of impartiality on the market, essentially benefitting the consumer.'*

The Trade association for insurers in Denmark, the legal expert in Poland, a broker and consumer association in Ireland consider the use of legislation as a suitable method.

The use of regulation was seen as having a neutral impact by a consumer association in Germany (although the respondent commented that a ban on commission could help) as well as by the regulatory authority in Denmark who commented however that *'regulation on remuneration creates more transparency of interest and independence of the distributor'*. The national authority in the Netherlands also commented *'this is hard to say. It can be an important factor but by itself it's not decisive. The crisis and the development of internet solutions is playing a big role as well.'* The legal experts in France also gaged the potential suitability as neutral. The Danish legal expert explained: *'Yes, but if there is an inherent conflict of interest, the RR will often only ease the symptom, not remove the conflict'*. The Italian legal expert had the same view and explained: *'The control or mere absolute value of remuneration rate does not seem to be necessary, if we exclude specific situation. On the contrary, clear rules of transparency concerning the roles and duties assumed by the intermediary may be more relevant. At the same time, the full disclosure of commission to be paid does not seem relevant.'*

However, it was not seen as suitable for a broker in Austria on the count that *'problems in Austria resulted of poor performance of products and fraud actions set by issuers'*. The trade Union consulted in Italy felt that *'there is surely more transparency, but however we are convinced that it is not particularly useful'*. Whereas the polish national authority

329 Answer to question D4 Q159.

330 Answers to question D4, Q158.

331 See Annex Table Q159.

believed that the current legislation was proper and did not see the need for further regulation.

A German respondent reminded that the introduction of remuneration regulation contains the danger that the information that must be provided to the consumer does not actually help them in their purchasing decision. For example it takes account of the European Commission preferred disclosure of the total remuneration amount as opposed to disclosure of the different individual forms of remuneration used in the various distribution channels.

5.8.2 Disclosure

Disclosure is a principle adopted because it is known to reduce (if not alleviate) information asymmetries to the benefit of consumers. Stakeholders commented on whether or not they were in favour of disclosure of status, role and dependencies of an intermediary. The responses, although not representative as such, build a strong case to indicate that transparency is a route likely to be favoured. Indeed, out of the respondents providing an answer on this question (a total of 13 in 7 countries) the large majority (11 respondents) thought that disclosure should be compulsory. Indeed, when asked if they are in favour of a duty to disclose status, role and dependencies of the intermediary, 86% are in favour of disclosure and consider that it should be compulsory (including respondents from AT, DE, DK, FR, FI, IE, IT, SL, PL). The rest, 14% preferred that this sort of information be disclosed on request (e.g. NL, FR).³³²

One respondent (a consumer association in the Netherlands) felt it ought to be on request only because it considered that *'the actual remuneration is more important than the kind of firm the intermediary is'*. A trade association for intermediaries in France believed such disclosures have little effects. They indicated that *'the notion of independence does not correspond with any reality in the real world. It is a myth because no intermediary can be truly independent on an economic, legal or financial level. The current Directive, which objectifies the relation between an intermediary and a firm is much preferable to the vague concept of independence, which has variable contours depending cultures and individuals'*.

The other respondents all favoured compulsory disclosures. For example, the Slovenian consumer association explained *'that consumers must know who the intermediaries work for to assess the level of their impartiality'*. Conversely, the Consumer association in Germany considers it *necessary information to estimate the interest of the intermediary* and the Polish Consumer association felt that *'consumers should be aware about the role of the intermediary'*. The legal experts echoed such support. In Denmark, the legal expert was of the view that *'it could be helpful for the consumer to know. However, the information should not be used to transfer responsibility of the intermediary's behaviour from the intermediary to the customer'*. The legal expert in France is in support of compulsory disclosure because *'consumers don't really understand that they are different types of intermediaries. They should know who they are talking to prior to contracting, and understand the mission of the intermediary.'* A similar position is held by the Polish legal expert: *'The client (consumer) should have the knowledge about possible dependency and conflict of interest regarding the intermediary.'* Finally, the legal expert in Italy supported transparency for *'all products and intermediaries'*. Two national authorities also supported compulsory disclosure because *'consumers normally do not ask for this kind of information'* (NL) and because it was already aligned with the status quo in Poland.

332 See Table Annex Q163.

The German respondent emphasised that the status information about the intermediary is of great importance for the customer. It is only this revelation that will inform the consumer about whose side the intermediary is working for and who will be liable for bad advice.

5.8.2.1 Disclosure of the amount of remuneration

Disclosure of the amount of remuneration that the intermediary receives is also an element that should be explored as a transparency tool. When asked if they are in favour of a duty to disclose the amount of remuneration the intermediary receives – 45% of our respondents agreed that this have to be compulsory (e.g. PL, NL, DE, DK, FR, SI) Another 27% consider that the type amount of the commission must be disclosed on request (e.g. FR, IT, PL). The rest 28% does not think that this type of information have to be disclosed (e.g. DE, FR, FI, IT, PL).³³³

Support for disclosure of the amount of remuneration is gathered on the basis that it can be difficult for the consumer to know or even calculate such an amount if he is not told it.³³⁴ Also, *'consumers must be aware of the remuneration the intermediary receives in order to assess their motives for focussing on a certain product'*.³³⁵

However it is clear that the amount of remuneration is not the be all and end all. Indeed, a number of comments were made warning of the limitations of such disclosure. For example, *'if information on the remuneration is important, consumers need to understand what stands behind the remuneration (what kind of service, etc.). If a service is cheap, it can be for various reasons. The amount of remuneration cannot be the only element to take into account. If the disclosure is compulsory, it might create new problems but if I is on request there is a risk that consumers will never ask, not knowing they can.'*³³⁶ According to the Dutch national authority, it is important to note that they *'experienced that transparency is not enough. Before the ban on commission we had rules for the disclosure of the amount of remuneration and the inducement rules. An evaluation of the inducement rules clarified that the inducement rules were helpful but not strong enough to stop the wrong incentives.'*

Further, some justifications were put forward in favour of disclosure on request or to oppose disclosure altogether. For example, awaiting the consumer to request the information would be because *'a disclosure of the amount of remuneration the intermediary receives does not seem always necessary as it is the final result that matters on the side of the client.'*³³⁷ It is also justified by the Polish legal expert because *'the client is generally interested in the total amount of the financial burdens connected with the agreement and not with the particular elements thereof. Further his remuneration might not be directly linked to the given agreement concluded with a client'*. Similarly, the Polish authority commented: *'the client is not always interested in the amount of remuneration'*. In favour of no disclosure the following argument was made by a trade association representing intermediaries in France: *'the amount of the remuneration is not a pertinent*

333 See Table Annex Q 164.

334 See on this point, the consumer association in Poland in favour of disclosure of the amount of remuneration because it can be an indicator of a mis-sold product. Similarly, disclosure may be necessary information to estimate the interest of the intermediary according to the German consumer association. Also see Legal expert in Denmark.

335 Answer from the Slovenian consumer association to question 164.

336 Answer from the French legal expert to question 164.

337 Answer from the Italian legal expert to question 164.

notion for the consumer. It is not comparable from one product to the other, from an intermediary to another! Disclosure detracts the attention away from the real elements to consider when making a choice'.

Germany³³⁸: The trade association for insurance undertakings is not in favour of disclosing the amount of the intermediary's remuneration with the reasoning that the amount is not relevant for the customer purchasing decision. In choosing a life insurance policy it is much more helpful to see the closing and on-going costs contained in the premium as this allows for a more neutral comparison across firms and distribution channels. Where necessary, this information could be accompanied by display of the resulting effect on the reduction in yield.

5.8.2.2 Disclosure of the origin of the remuneration

An additional piece of information that may be of use to consumers concerns the origin of the remuneration. When asked if they are in favour of a duty to disclose the origin of remuneration, over a half of our respondents (64%) consider this should be compulsory (e.g. DE, DK, FR, IT, IE, NL, PL, SI). On the other hand, 27% believe that the disclosure ought to be on request (e.g. DK, DE, FR, IE, IT). As for the rest (8%) preference for no disclosure of such information was expressed. (e.g. PL, FI)³³⁹

There is support for compulsory disclosure of such information. A Polish consumer association considers that 'consumers should be aware about the origin of remuneration as this is related to dependency of the intermediary', a position also taken by the consumer association in Slovenia. Similarly, the German consumer association believes it necessary information to estimate the interest of the intermediary. In Denmark, *the legal expert thought it should be compulsory disclosure because it could be helpful for the customer to make informed choices*, whereas the Danish legal expert thought that the '*client (consumer) shall have the knowledge about possible dependency and conflict of interest regarding the intermediary*' because '*the origin of remuneration have direct impact on these issues*'. These positions were echoed by the national authority in the Netherlands. By contrast, the Polish national authority is in support of disclosure on request because '*the client is not always interested in the amount of remuneration*'. Further the French legal expert warned that '*having access to the information is important but consumers need to understand what it means. I'm not sure any consumer can understand. Giving information they don't understand could create suspicion for the wrong reasons*'. In Germany, an industry trade association believes that disclosure of the source of the incentive should be upon request of the consumer since providing the intermediary/adviser does not bring up the subject of a fee-for-service it is evident to the consumer that the remuneration for the advisory service is included in the premium through commission.³⁴⁰

5.8.2.3 Disclosure of caps on certain commissions

Disclosing the existence of a cap on commission can have positive impact and is welcomed by some stakeholders. Yet, when asked if they are in favour of a duty to

338 iff own translation. Original answer: Der Betrag der Vermittlervergütung ist für die Kaufentscheidung des Kunden nicht von Bedeutung. In der Lebensversicherung helfen vielmehr die in die Prämie einkalkulierten Abschluss- und Vertriebskosten, so dass der Kunde eine unternehmens- und vertriebswegeneutrale Vergleichsmöglichkeit erhält. Ergänzt werden kann diese Info um eine Angabe über die daraus resultierende Renditeminderung.

339 See Annex Table Q165.

340 iff own translation. Original answer: Soweit der Vermittler/Berater nicht nach einem Honorar fragt, ist für den Kunden klar, dass die Vergütung der Beratungsdienstleistung in die Prämie via Provision einkalkuliert ist.

disclose a cap on certain commissions, only 36% of respondents answered that they are in favour of a duty of disclosing a cap on commission (e.g. PL, FR, IT, NL, IE, SI). By contrast, 55% are not in favour to do so (e.g. DE, DK, FR, FI, IE, IT, PL). For the rest 9% this information turns out to not applicable.³⁴¹

Indeed, the Consumer association in Poland states support for such disclosure because *if an intermediary is obliged to disclose a cap on a commission, he is be less likely to take higher commission than is allowed*. This is a view echoed in Slovenia, where the consumer association consulted indicated that *'in order to lessen the appetites of intermediaries, the caps would be a suitable choice'*. The French legal expert believes that disclosure may be useful for *'some type of acts such as modification of contract clauses or termination of contracts'*. Similarly the Italian legal expert also sees limitation in such disclosures to specific cases. The Dutch authority also recommended disclosures of caps: *'if there is no ban on commissions, inducement rules with a cap on commissions is a good step for RR'*.

However, on its own this type of disclosure is unlikely to *solve the problem of conflict of interests and bad and wrong advice* according to the German consumer association. It also could *result in information overload* and is not necessary according the Danish legal expert. Further, such disclosure would require price regulation in the first place, an option disfavoured by the national authority in Denmark. The German industry representative also explained that it would not be in favour because as long as caps on commissions are in place, such as those provided for in § 12 Abs. 7 VAG governing substitute health insurance, the height of the commission is not a relevant decision factor for the consumer.³⁴²) besides, it may be difficult to find the right caps in any event.³⁴³

5.8.2.4 Disclosure of a ban on certain commissions and other type of information

When asked if they are in favour of a duty to disclose a ban of certain commissions, 64% answered that they are in favour of disclosing (e.g. DK, DE, FR, FI, IE, IT, NL, PL, SI). The other 36% were not in favour (e.g. DK, FR, IT, NL, PL)³⁴⁴. The justifications given to support the choice of yes or no however, indicate that many respondents answered on the principle of a ban rather than its disclosure. As for disclosure, the Danish legal expert warned of the potential information overload that may result from disclosure of the information concerning the fact that a ban is in place. It is after all information that is not necessarily essential. The French consumer association also noted that to be efficient, legislation must include all commission whatever their form and whatever stage they are due.

5.8.3 Effectiveness of regulation to control remuneration structures

Our survey focussed on gathering the views of stakeholders on a number of issues all informing the effectiveness or lack thereof of the use of existing regulation as a control mechanism.

341 See Annex Table Q166.

342 *iff* own translation. Original answer: Soweit Provisionsobergrenzen festgeschrieben sind, ist dies gesetzlich geregelt wie in § 12 Abs. 7 VAG für die substitutive Krankenversicherung. Die Höhe ist für den Kunden nicht abschlussentscheidend.

343 Answer from NL, user stakeholder to Q166.

342 See Annex Table Q167.

5.8.3.1 Significance of national regulation

We first asked our respondents to rate and explain the significance of existing Remuneration Regulation on a sliding scale. Interestingly, 64% of respondents felt that regulation controlling remuneration was very effective or effective (e.g. DK, FR, FI, IE, IT, NL, PL), against 36% considering it that it was of low effect or ineffective altogether (e.g. DE, FR, PL).³⁴⁵

Legislation is considered effective in Denmark by all respondents (representing a trade association, the national authority as well as the legal expert). The effectiveness was identified as deriving from rules of good conduct and a ban on Commission, and the fact that brokers' independence is now stronger and as a result the advice given is not tinted with the temptation to mis-sell because of the available remuneration. However in France effectiveness is less obvious with two respondents taking an opposite view on the impact of regulation. Indeed for the legal expert consulted, remuneration regulation is ineffective, whereas the consumer association felt that it was effective. However, the respondent qualified his answer with the following statement: *'the current remuneration regulation does not seem capable of reassuring consumers concerning the impartiality of the advice he receives when subscribing to financial products.'* A mixed picture also exists in Slovenia where 'after the adaptation of national rules in 2010 certain aspects of it were improved (especially regarding disclosure of information on contracts) but most of the pressing issues are still not regulated properly or clear enough.' Nevertheless, in Poland, the regulation is considered of low effect by the legal expert because the 'the existing RRs are very general and limited and therefore do not impose any detailed obligations in relation to clients .' the German consumer association also had a negative view of the effectiveness of regulation considering that consumers do not get full disclosure of commission and because there is a tendency towards so called *Festpreisgeschäfte* where no disclosure is claimed.

5.8.3.2 Ease with which intermediaries and providers are able to elude the rules

Yet, to fully appraise significance and efficiency it is important to know how easy it is for intermediaries and providers to elude the rules in place. Out of our respondents, 27% agree that intermediaries and providers are able to elude rules. Another 27% does not agree that rules could be eluded. The remaining 46% are not aware or do not know if providers and intermediaries are able to elude rules.³⁴⁶

The reasons why providers and intermediaries are able to elude the rules is because it is 'easy for an intermediary to dilute the information about the RR (drawn it) in the middle of the terms of the sale (general conditions) which the consumers read very little due to their lack of accessibility, according to the French consumer association. Similarly in Germany the consumer association considers: *'easy to elude because the disclosure needs are fulfilled when it is disclosed on a general basis'*. In Slovenia, another explanation is put forward by the consumer association. Evasion is due to vague definitions and descriptions in the regulation [giving] too much room for different interpretations by intermediaries.

5.8.3.3 Improvements in the quality of advice and the ability of RR to alleviate consumer problems

First, we asked our respondents to indicate the extent to which they agree that RR has improved quality of advice using a sliding scale, where respondents were able to agree,

345 See Annex Table Q170.

346 See Annex Table Q171.

partly disagree or disagree. Only 18% agreed that quality of service has improved thanks to RR (e.g. DK, FI, IT, IE). Another 41% did agree only partly that the regulation had improved quality of advice (e.g. AT, DE, FR, IE, IT, PL, SI). The rest (41%) disagreed or were not aware or did not know whether the RR has improved the quality of the financial advice (e.g. DE, DK, FR, IE, PL, NL).³⁴⁷

All Danish respondents felt that the quality of advice had improved in Denmark. They singled out the impact of MiFID, the ban on commission and the rules of good conduct basis for improvements. In Ireland, the impact was because it made providers focus according to a broker. However, the consumer association in Ireland disagreed and felt that there was no evidence that advice had improved. The same scepticism was found in France and Italy where the consumer associations also explained that they had not seen evidence of any notable improvements. The same views were echoed in Slovenia by another consumer association which explained: *'it has improved certain aspects, but since the practices of the sellers are very hard to prove, many just continue doing what they were always doing - misinforming the consumers without consequences. There is a great difference between the practices prescribed by the RR and the actual practices we come across on the market.'*

Second, our respondents were asked to indicate the extent to which they agree that RR has alleviated consumer problems. This is question that is difficult to answer since our respondents would not, on their own, have access to relevant data. 19% agreed that RR alleviated such problems (e.g. DK, FI, NL, PL), whereas 27% have answered the opposite (e.g. DK, FR, NL). The rest 64% are not aware or do not know if the RR has caused consumer problems (e.g. DE, DK, FI, NL, PL).³⁴⁸

5.8.3.4 Effectiveness of control mechanisms and regulation in place at national level

When asked to indicate the extent to which they agree that the existing regulation is effective³⁴⁹ (including control mechanisms), 35 % of the respondents agreed that the existing regulation is effective (e.g. DK, FI, FR, IE, IT, NL, PL). This is for example, the position of the Polish legal expert who said: *'In our opinion the existing regulation as whole is rather effective'*. Yet, 23% indicated inefficiency on behalf of the current regulator. The rest (48%) are not aware or do not see efficiency as regards to the existing regulation. The role of regulators was brushed on here by respondents, as well as the way regulation takes form. For example, the Danish legal expert thought that regulation in his country is fragmentary with a multitude of differing regulation and that there is a need for an overall and homogeneous regulation. Similarly even if positive effects are felt, more seem to need to be done. In France, the legal expert made the following comment: *'Regulation by the ACP is satisfactory but there could be more control. We also think licensing should be delivered by a public authority. For the moment ORIAS is an association, the members represent national professional federations.'*³⁵⁰ *It's more or less like self-regulation. As Orias is financed by the members there is a risk of conflict of interest even if the control of the activities is done by ACP. The minimum should be to have members representing consumers in the association'*. In the same vein, in Slovenia the Consumer association noted that regulation has certainly caused some improvements

347 See Annex Table Q173.

348 See Annex Table Q172.

349 See Annex Table Q176.

350 <https://www.orias.fr/documents/13705/0/Qu%27est%20ce%20que%20I%27ORIAS%20.pdf>

and certain steps in the right direction but it still needs to be improved drastically in order to cause actual and beneficial effects for consumers on the market.

5.8.3.5 Impact / effect of remuneration regulation in member states where it was recently introduced

Two main avenues of enquiry were followed here: assessing the impact of regulation on intermediaries and the effect on consumer problems.

First, we asked our respondents, in countries where some regulation of remuneration has been introduced recently, to comment on its impact on the different types of intermediaries/distributors.³⁵¹

In Denmark, 2012 is the first year where the brokers have to be paid exclusively by the customer. The national authority commented that it has not yet received the income figures from the brokers for 2012 but that it expected a minor decrease of the brokers income for 2012. The trade association reported a 'change in business model for independent brokers as a consequence of the ban on commission' but did not foresee a change in revenue for independent brokers.

In Finland, the impact of the commission ban (introduced in 2008) is as follows (according to a trade association): 'no major changes in the amount of brokers and their staff. The total amount of brokers' fees has been growing and is about on the same level as the level of commissions before the commission ban. The brokers' market share has seen some changes in different insurance lines: there's strong growth in certain non-life sectors, whereas there has been decline in the life sector. Source: yearly statistics of the Finnish Financial Supervisory Authority.

In France, the consumer association explained: 'too often we notice that regulation is leading to an increase in the size of the contract offered to the client and as a result it appears to be difficult to measure its efficiency.' But in Italy, the legal expert considered that some regulation was having positive effects thanks to the case law of the Arbitrato Bancario Finanziario. However, other RRs are yet to show a positive effect. Finally, in the Netherlands some preliminary research show that the market share of intermediaries decreased from 52% in 2012 to 36% now.³⁵² Although the Slovene consumer association believed that in Slovenia the number of intermediaries is increasing.

Second, we also asked our respondents what has been the impact or the effects of recently introduced RR on consumer problems.³⁵³ Respondents volunteered a series of example of impact. In Germany for example, the health insurance market seemed to have lost credibility and public acceptance and confidence after high media scandals. Thus Germany introduced a cap on commission in the private health insurance sector (Vergütung in der substitutiven Krankenversicherung, § 12 Abs. 7 VAG.) to restore confidence. In France however efforts are not perceptible in ameliorating consumers' plight. Similarly in the Netherlands, the respondent explained that effects were not yet known. There is some additional information however, which indicates that there are more (partial) do-it-yourself tools available. Customers get a discount on the fee if they do more themselves, according to the consumer association consulted for this survey. Neutral effect is also noted in Slovenia. The consumer association explained: *'we are not noticing any*

351 See Annex Table Q177

352 <http://www.eufin.nl/vaknieuws/64-vaknieuws/30850-gfk-consument-kiest-bij-hypotheek-steeds-vaker-voor-de-bank>.

353 See Annex Table Q179.

change in numbers of consumer complaints. Numbers tend to increase, if anything. With regards to the effect of RR on the existence of certain products, Insurance providers are trying to adapt their products to perceived needs of consumers, but these are generally more marketing touches than actual benefits for consumers.' Finally in Denmark there appear to be less problems with lack of transparency than before according to a trade association for insurers. In Finland, despite the absence of fresh studies on this subject, there are no reported major problems in this field according to another trade association.

5.8.3.6 Gaps in control (regulation and control mechanisms)

Effectiveness of Regulation can also be measured by reference to gaps that exist in the legislative arsenal itself as well as the gaps in control and enforcement mechanisms. Our questionnaires asked respondents to comment on the lack of regulation on certain products and intermediaries as well as lack of control mechanisms for specific products or intermediaries.

When asked to indicate the extent to which they agree that there is a lack of regulation of certain intermediaries or products, 46% of our respondents agreed that there is a lack of regulation (e.g. AT, DE, DK, FR, IE, IT, NL, PL, SI), whereas 32% answered the opposite (e.g. DK, FI, IT, IE, NL, PL). The rest 22% do not know or are not aware of lack of regulation (e.g. DE, DK, FR, NL).³⁵⁴

For example, in Denmark it seems that the regulation of financial undertakings selling of products under the term 'advice' need to be improved according to the legal expert consulted. In France, attention should be paid to a *'category of providers who can sell insurance (phone insurance, insurance for certain goods and products) without having to know much about the product and not having to register at ORIAS. They are responsible if there is a lack of information or advice but the problem should be solved before. Consumers shouldn't always have to claim.'* In Italy, a gap was identified for credit intermediaries where there is the existence of more than one intermediary for the same products or linked products. In Poland, there is a reported lack of sufficient regulation on remuneration questions with regard to intermediaries working on behalf and/or for the benefit of the client (brokers) according to the legal expert. Finally the consumer association answering in Slovenia noted that the RR is not covering the whole scope of the insurance market.

Further, when asked to indicate the extent to which they agree that there is a lack of control mechanisms for certain intermediaries or products, 32% of our respondents answered that there is lack of control mechanisms (e.g. AT, DK, FR, IE, IT, NL, PL). On the other hand another 32% (e.g. DK, FI, IT, IE, PL, NL) consider the opposite that there is no lack of control mechanisms. Indeed in Poland for example, both the national authority and the legal expert felt that controls were adequate. The national authority believes the regulation is proper and the legal expert is satisfied that there are sufficient control mechanisms in Poland. The rest 36% are not aware or do not know of lack of control mechanisms (e.g. DE, DK, FR, NL).³⁵⁵

Control mechanisms are extremely important. As the German consumer association puts it: *'the best control mechanism together with weak rules does not help.'* In Slovenia, the respondent (CA) explained that *'it is difficult to control what intermediaries and agents say or do not say when selling insurance products. When there is a problem it is the*

354 See Table Annex Q174

355 See Annex Table Q175.

consumer's word against the seller's word. Consumers are finding it very hard to prove their point without hard proof'.

It is therefore important to find effective means of control. The legal expert in Denmark volunteered the use of mystery shopping while the trade association in the same country mentioned more transparency concerning the brokers' business models and the publication of financial key figures. In Italy, the legal expert advocates for perhaps stringent mechanisms than have been put forward by our Danish respondents. Indeed, in Italy *'the lack of control is maybe not to be traced in the lack of loans of existing regulations, but mostly in a lack of controls. In fact, in many cases, procedures against intermediaries are the consequence of complaints by clients or consumer associations, but there is not a preventive action by control authorities. In my view, in many cases, criminal sanctions and prosecutions should be pursued: for example, in the case of fraud.'*

Gaps were also identified in France by the legal expert who explains: *'It shouldn't be possible to get a different level of information and advice depending on the professional you are talking to. For example, in France you might not have the same level of advice if you contract with an employee or with an intermediary (except for life insurance). This should not last very longer regarding IMD2'.*

5.8.4 Non-regulatory measures

As regulation cannot in itself take care of all bad behaviour, it is important to turn to other means. We asked our respondents what kind of measures other than RR would be effective to alleviate problems.³⁵⁶ The question suggested two examples, namely, professional qualifications and raising awareness in the media. Unsurprisingly, many respondents commented on those two methods. It is worthy of notice, that the use of the media may have expensive costs associated with it (a comment made by a consumer association in Poland). Concerning professional qualifications, the French legal expert opined that *'more qualification requirements could help giving the correct information to the consumer, particularly in bancassurance where the employees have to know how to sell a credit, insurance, investment products, phone (...). Maybe if it was different employees they could all be specialised and know what they are talking about. At the same time we know that the intermediary does not always have/take enough time to explain the contract. Consumers also need to be more educated. Knowing how to read a contract, what they have to look at precisely'.* The Consumer association in Slovenia indicated that *'agents and intermediaries undergo short trainings upon which they are supposedly qualified to sell complex insurance products. From our experience even they themselves often do not know or understand the products they are selling, but they do understand what kind of remuneration a certain product provides for them. As a consumer organisation we are working on raising awareness in the media as well as putting pressure on the regulators to address the problems we encounter in our research and upon consumer complaints'.*

Other measures aside from the examples given came to the fore. This includes financial education, transparency methods and bans (although those methods are regulatory) and self-regulatory initiatives. Indeed, the German Trade Association for insurers commented that *'in addition to an appropriate education and training of intermediaries, new customers should already have received basic financial education lessons in their school years in*

356 See Annex Table Q161.

order to contribute to keeping moderate information asymmetries.³⁵⁷ School education is also something that a French trade association intermediary found likely to be valuable.³⁵⁸ Client awareness and financial education was an answer also given by a trade association in Finland.³⁵⁹

Meanwhile the consumer association consulted in Germany expressed a different view. It explained that a *'ban of commission is a necessary pre-condition. All other regulation ideas do not solve the problem. If the solution is transparency only, it must be a real transparency in Euro and Cent, and pre-contractual and per yearly bill'*. This was a view shared by the French consumer Association: *'it is necessary to regulate the financial products themselves across the EU. They are too complex to be understood by the consumer who is not intended to be a financial expert and who as a result of this complexity finds themselves at the mercy of the professional to whom he is dealing with'*.

Information however received support from other respondents.³⁶⁰ This is for example the case of the national authority in Denmark, which indicated that *'information and disclosure rules regarding the remuneration received might be a step forward'*. Transparency and self-committed initiatives were also cited by the Danish Trade association. A trade Association for intermediaries in Ireland also explained: *'complete transparency around all costs, direct and indirect, including all distribution costs of insurers and let the client decide'*. By contrast, the legal expert from Denmark warned that *'more information is not the cure for everything. Banning certain kind of activities could be used, where a severe conflict of interest cannot be avoided, and where there are alternatives'*.

Overall it seems that most respondents would not rely on a single method but tended to cite a combination of them as a way to enable effective control. For example, a broker and Ireland answered: *'qualifications, continuous professional development, consumer education'*. A combination of solution is also the line taken by the Dutch authority which provided the following information: *'next to a ban on commissions we also increased the professional qualifications and we have rules on product approval. This combination of rules should increase the quality of financial services and financial products and enable consumers to be critical at the quality of the services and products'*. Meanwhile a Dutch consumer association referred to yet another mix composed of *'a licensing system for financial intermediaries. Financial education for consumers, so that they are a better market party and media attention to raise awareness of current mis-selling'*.³⁶¹

357 *iff* own translation: original answer: Neben einer angemessenen Aus- und Weiterbildung der Vermittler sollten auch zukünftige Kunden bereits in ihrer Schulausbildung eine finanzielle Grundausbildung erhalten, um Informationsasymmetrien gering zu halten.

358 The respondent explained: 'An increased level of competence from both customer and intermediary is welcome. Financial education should be taught at school. Note however that for [our trade association], this is not enough to bridge the information gap between consumers and professionals and it is this irreducible gap that the interest for receiving advice manifests itself.' *iff* own translation. Original answer: Toute élévation du niveau de compétence des intermédiaires mais aussi des clients est bienvenue. Il faudrait d'ailleurs enseigner l'éducation financière dès l'école. A noter toutefois que, pour [notre association], cela ne suffira pas à combler l'asymétrie d'information entre les consommateurs et les professionnels. C'est d'ailleurs là, dans cet écart irréductible, qu'intervient l'intérêt du conseil!

359 Financial education is also the answer given by the TU in Italy and the Authority in Poland.

360 The legal expert in Italy explained that 'direct comparability of the final costs of the products seem to be more effective, at least in case of standardized products'.

361 The legal expert in Poland suggested: 'raising awareness in media, in particular in relation to consumers, introduction of certain information obligations, in particular with regard to total costs of products'.

5.9 Conclusion

Remuneration regulation takes various forms and there is no one model that prevails across the member states studied. Legislation and case law tend to be primary sources, but codes of practice in the form of principles for businesses, are also in use. Overall, it is a patchwork of regulation that applies in all member states included in this study. The study did not seek to investigate how efficient the architecture of the legislation in place was, due to the many factors that contribute to the efficacy or demise of legislation in place at national level. As a result, the study refrains from assessing if the current national legislations available are able to deliver good results for consumers. Indeed, if legislation is impeccable, but access to court is problematic, consumers will not obtain the protection they require. Similarly, if law is not available but soft law is embraced at national level, the system may overall give adequate protection to consumers.

However, although we cannot comment on the form legislation takes a few key elements seem to be necessary in legislation that seeks to protect consumers against any conflicts of interests. Those include four pillars: dependency, transparency, prohibition of certain remuneration forms and professional qualifications. They were present in different dosage in all the member states included in our study.

The study established that most of the key notions such as remuneration types and intermediary types tended to be defined in different ways. Some member states define and regulate activities, while others focus on persons. There is no harmonised understanding of what conflicts of interest are, and what behaviours should be expected from different intermediaries. This explains in part diverging requirements with regards to authorisation and licensing, with some intermediaries subject to professional qualifications while others are not.

A large number of restrictions are in place, all focussed on a variety of intermediaries or products. The main types of restrictions include employee remuneration, caps on remuneration, forfeiture of remuneration and duration of contracts. A number of bans are in place mostly targeting brokers. While, those bans can have some positive impacts, the evidence points towards limited effects and in worst cases, negative impact on competition as well as consumers. In particular, the exclusion of many consumers, pushed into an advice gap is worrisome. Bans tended to be justified on grounds that to avoid conflicts of interest, the ban was the most efficient vehicle. Bans seemed to be reserved to niche products or types of intermediaries (although the ban in the UK is broader). This has the propensity to cause detriment for the most vulnerable consumers and confuse the field for all consumers, because rules on protection may change from one product to the next or from one intermediary to the next. This may make comparisons difficult.

Transparency measures also contribute to enabling consumer to make informed decisions and compare offering. The study found that transparency obligations vary in national legislation but overall, all countries required some disclosures to be made to consumers in order to inform their choices. Some of the transparency obligations observed belong to supervisory law. They therefore deal with the relation between public authorities and intermediaries, although those rules have some indirect benefits on the protection of consumers. Much transparency laws however have been developed to protect consumers directly against information asymmetry and conflicts of interest. While there is support from stakeholders for enhanced transparency, much care needs to be taken. Indeed, the study shows that with transparency, safeguards and adequate supervision also needs to be put in place. Transparency is necessary and useful only if deployed in a way that enables consumers to understand the key elements presented to them. For this to happen, three

elements are crucial: timing, form and content. The advice necessary to make the right decisions for consumers needs to be dispensed at an opportune moment. It has to be part of the sale process and part of the offer. Further, the form of the disclosure is as important as its content. It seems that the main elements necessary for consumers to make informed choices include the amount of the remuneration and the service allied to it, as well as clear information on the dependencies of the intermediary.

Enforcement is also crucial to enable consumers to find effective protection (administrative intervention) as well as remedies when rules have not been respected (private redress). At today's date it seems that public and private enforcement can be improved. In particular the lack of group remedies offered to consumers seems regrettable. The UK experience in this context shows that positive results can be achieved from super-complaints forcing the regulator to take action. The examples of the Financial Ombudsmen also show that consumers can access adequate redress at minimum costs in the countries such systems are in place.

In the following table we have tried to give an impression on the broad variety of regulations. Rules derived from general contract law like restrictive default rules, liability of the principal for the agent's behaviour, the general duty of good advice in culpa in contrahendo, usury rules or general consumer protection law concerning door-step-sales or standard contract term law have been neglected although they may have insurance specific exceptions.

Table 28: Regulation of insurance intermediation - overlook

AREA	ITEM	EXAMPLES
Products covered		contract-types ruling different distribution-channels and advice, e.g. contract for services, service-contract etc.
		Provisions regulating a certain area of remuneration in general, e.g. certain distribution channels and certain products. e.g. In Germany, InstitutsvergV for banks or VersVergV for insurance companies; In Italy, ISVAP-VO 39/2011 and Codice di Autodisciplina delle Società Quotate. (DE, IT)
Transparency	Dependency of intermediary Information about affiliation	e.g. Article L520-1 of the Insurance Code (FR). Includes identity, financial links with insurers, exclusive agent or other type, ability to provide objective advice if not tied, disclosure of holdings higher than 10%, or if more than 33% of turnover realised with one company. e.g. Irish Consumer Protection Code 2012, the term 'independent' may only be used where the intermediary provides services on the basis of a fair analysis of the market and allows the consumer the option to pay in full for the service by means of a fee. (IE)
	Information about the person paying the remuneration to the intermediary	e.g. COBS 6.4.11G statement on commission should include Amounts or values of commission rounded as appropriate, The names of the firms involved in paying and receiving commission or commission equivalent, A plain language description of whether remuneration takes the form of commission or commission equivalent. Commission equivalent could, for example, be described as remuneration and services received from XYZ Ltd". The timing of payments and period over which they are paid, etc. (UK)
	Information about the amount of remuneration	e.g. kick-backs disclosure in Germany (DE). e.g. brokers under an obligation to disclose their commissions received from the insurers when the broker also receives fees from the clients in exchange of its services. (ES, SI)
	Price disclosure	e.g. IMD II proposes to disclose all commissions in the sector of life insurances e.g. German law agents and other distribution channels shall disclose commissions that exceed 15% of the annual premium. (DE)
Good advice		wrong advice and damage compensation e.g. according to German jurisprudence, providers or intermediaries shall compensate all damages caused by wrong advice, by undisclosed commissions that exceed 15% of the annual premium for example. (DE)
	Conflicts of interest	e.g. According to German law, paragraph 31 WPHG, securities-related services enterprises shall avoid conflicts of interest in order to achieve the best results for their clients. (DE)
Limits on Remuneration	Caps	e.g.: according to German law, paragraph 12 VVG, the commissions paid for by private health insurers must not exceed 3.3% of the annual premium. (DE) e.g. usury laws. According to German jurisprudence, premiums are declared void if they exceed the double of the average. (DE)
	Early cancellation	Provisions regarding risk-taking in cases of early cancellation. According to German law, § 80 VVG provides for the calculation and distribution of the already paid commission amongst the consumer and the provider. (DE)
	Salary	IVASS Regulation no. 39 of 2011 in Italy. This Regulation provides specific rules concerning remuneration policies for insurance companies' personnel. (IT)
	Sharing of remuneration	e.g. special provisions in Germany (DE)
	Bans	ban of certain remuneration schemes e.g. Retail investment advisors who may not charge commission for investment advice but must agree a fee in advance with a client in the UK under the Retail Distribution Review. (UK) e.g. life insurance intermediaries are restricted from receiving commissions on mediated insurance products. (FI, DK)
Restrictions on duration	Duration of contract	Limits on automatic renewal. (IT)
	Distribution of remuneration over contract time	e.g. Article 169 (3) German Law on Insurance Contracts where the initial cost (commission, fees) have to be distributed equally over the first five years when calculating the residual value in case of early termination
	Cooling off periods	e.g. ICOBS 7 sets out the cooling-off cancellation rights and the consequences of cancellation. (UK)
	Early cancellation	provisions regarding risk-taking in cases of early cancellation e.g according to German law, § 80 VVG provides for the calculation and distribution of the already paid commission amongst the consumer and the provider. (DE)
Sources	General Legislation	Civil and tort laws (all)

AREA	ITEM	EXAMPLES
of regulation		E.g. Article 758 para 1 and 2 Polish Civil Code - when a contract does not specify the manner of remuneration, the agent is entitled to a commission which depend on the number of value of the contracts (sale or contingent commissions). (PL)
	Specialised legislation	Securities Markets Act 24/1988 (ES) Private insurance and reinsurance mediation Act 26/2006 (ES)
	Case law	Fiduciary duties (UK) Interpretation of general and specialised legislation (all)
	National authorities conduct of business rules	Financial Conduct Authority Handbook including High level principles for Business and ICOBS and COBS (UK) Retail Distribution Review (UK)
	Self-Regulation and industry codes of practice	Uni Finance Global Union's Model charter on Responsible Sales of Financial Products Professional bodies' supervision
Inter-mediar-ies covered	Professions covered by regulation	Brokers (insurance brokers, investment brokers), Agents (tied-agents, linked-agents, exclusive agents, insurance agents, investment agents, banc-assurance agents) Financial Advisers (independent FAs).
	Activities covered rather than professions	The FCA Handbook Glossary defines an insurance intermediary as "a firm carrying on insurance mediation activity other than an insurer" (UK)
Authorisation & Licen-sing	Licensing by profession (may include professional exams)	No licensing requirements for Advisors (FI, IT, ES). Brokers subject to licensing/ authorisation (FI, IE, IT, SI, UK, PL, FR, DK, ES, DE). Agents subject to licensing or less stringent forms of control according to the level of dependency they may have and the perceived dangers such dependence may have on them.
	Blanket requirements	In France, all insurance intermediaries are subject to an authorisation (licensing) regime under Article L512-1 of the Insurance Code. Registration occurs with ORIAS. (FR)
Super-vision	Administrative supervision	e.g. according to German law, § 39 WPHG, providers shall pay an administrative fine (punitive damage) if they infringe upon the duty to disclose conflicts of interest. (DE)
	Group/ representative actions	e.g. Super complaints to the OFT or FCA (UK).
	Private action	Ombudsmen systems (FI, DK, UK). Court Action (consumer redress, unfair competition, unfair commercial practices) (all)
	Professional bodies supervision	Code of practice, Ethics rules

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Annexes

Annex I: Methodology of the survey

The study was started from a theoretical analysis, the empirical information available through literature and experts and the results of questionnaires collected from stakeholders. This study and its results are not intended to provide representative results in the sense of statistical evidence. Rather the study seeks to offer an insight into current issues facing the insurance industry with regards to the way remuneration structures may influence wrong-doing. This section of the report explains the method used and the results of data collection efforts of the research.

Research tasks

Below is a reminder of the tasks and questions of the research.

Table 29: Tasks of the Study taken from the ToR and source of information

	TASK	ASPECTS	MAIN SOURCE*
1	Status of existing remuneration models (inventory, data collection)	wide understanding of "remuneration" of intermediaries including direct and indirect as well as non-financial incentives to sell certain products, assessment of fee-based systems where the consumer is directly charged by the intermediary	Industry (insurers and intermediaries) survey and interviews Trade unions Authorities
2	Evaluation of existing regulation	Existing body of law governing the remuneration system in financial services especially in insurance law but with examples also in bank activities which comprises also such bank activities in which banks themselves act as intermediaries for insurance products.	National experts Regulators Consumer associations
3	Mapping of possible measures for improvements of remuneration schemes.	concepts, opinions and existing models to improve financial advice and sales through new regulations and mechanisms including caps, disclosure rules, professional qualification, admission, supervision, and especially incentives for the use of such advice which is directly paid by the consumers including the advice provided by independent advisors on a fee basis	All stakeholders (views) National experts Research Team

Note: As featured in the Inception report from 7 March 2013.

The study aimed from the outset to have an exemplary character for the covered area and the received legal and factual information for the Member States in the scope of the research. Representative data proved to be impossible as expected in the proposal. The research relied on a methodology that is explained below.

A particular focus of the research on life insurance was agreed for the study. The selection of 10 EU Member States as stated in the terms of reference of this study was modified slightly to include Ireland instead of Lithuania on request of the FSUG³⁶².

Among the many different products, the research did not set out to make an inventory of them but only focused on identifying those that were associated with existing problems and with the subject of the study: financial incentives for the sales of financial products.

³⁶² The final ten covered Member States include: Spain, Germany, United Kingdom, France, Italy, Poland, Denmark, Finland, Ireland, and Slovenia. In addition, information from Netherlands and Austria were also provided.

The products of greatest interest were the four which the research team had included in its questionnaire, namely: Capital Life insurance (endowment); Payment protection insurance; car insurance and health insurance. Research was mainly focused on collecting information and data for these product classes. However, such a level of detail was often not available from potential respondents, who if they had statistics to share, these were only available in aggregated form distinguished between life insurance and non-life insurance (i.e. general insurance).

Methodology

The research used both primary and secondary sources of information. In March 2013, the team concentrated on developing the theoretical approach underpinning the research and using the findings from the theoretical clarifications to inform the lines of questioning of the questionnaire. In April, a lot of effort was extended improving the design of the draft questions and continuing to identify the entities in question and contact persons at these organisations. By end end of April we had received the signed letter for the project (14 April 2013) and proceeded with sending out the final version of the questionnaires. The finalised questionnaires were sent to the key stakeholders on 24th and 25th of April, and to subsequent stakeholders including the providers over the weeks thereafter. Although the initial deadline given to respondents for submission of responses was 31 May 2013, we realised that an extension was clearly requested and necessary, also because some of the additional providers were contacted later in May. Reminder emails were then sent in June and July. Because of the busy EU regulation agenda and ongoing consultations affecting the insurance industry, several industry potential respondents told us that competing deadlines end of June would make answering our questions impossible before July. The summer period starting in July meant that the follow-up calls were largely unsuccessful due to some persons being on holiday.

Desk research took place at the start and throughout the research project. It was mainly focused on collecting the relevant data and information from academic literature and more public sources, including on aspects related to inadequate sales in the insurance sector where available.

Field research

The survey questionnaire³⁶³ was central to the research effort. The stakeholder responses were designed to provide data on the situation in the 10 Member States chosen by FSUG to represent the general European situation. The survey was based on a unique questionnaire distributed in a transparent way to all stakeholders with a clear request directing the respective respondent type to the sections of the questionnaire containing the questions most targeted and appropriate for them to answer. A general part on opinions (Part D of the questionnaire) was open to all stakeholders to answer, with the intention of having subjective views on the relative importance or pertinence of various regulatory options that would enable qualitative explanations to substantiate views. Below is a box showing the structure of the questions:

363 See Annex document to this Report containing the questionnaire used.

Structure of the questionnaire

The questionnaire started with an introductory page and a couple graphical representations of the subject matter and categorisations, with questions broken down into 5 parts:

Part A addressed national regulators, competent authorities but also trade associations for data on intermediation and distribution of insurance products. The questions aimed to collect data on national market size, number of active distributors and share of market by distribution channel as well as remuneration systems for the four product classes.

Part B concerned consumer problems and potential detriment with the sale and intermediation in the insurance sector. It is a part which all respondents were expected to reply to, but primarily the consumer associations and regulators

Part C was primarily for our legal experts, as it concerns the questions regarding regulation. Regulators and Industry did however sometimes also provide answers.

Part D of the questionnaire contains questions regarding opinions on the subject of remuneration and consumer outcomes including subjective or substantiated assessments of existing or possible regulation and its effectiveness. All respondents were asked to complete this section.

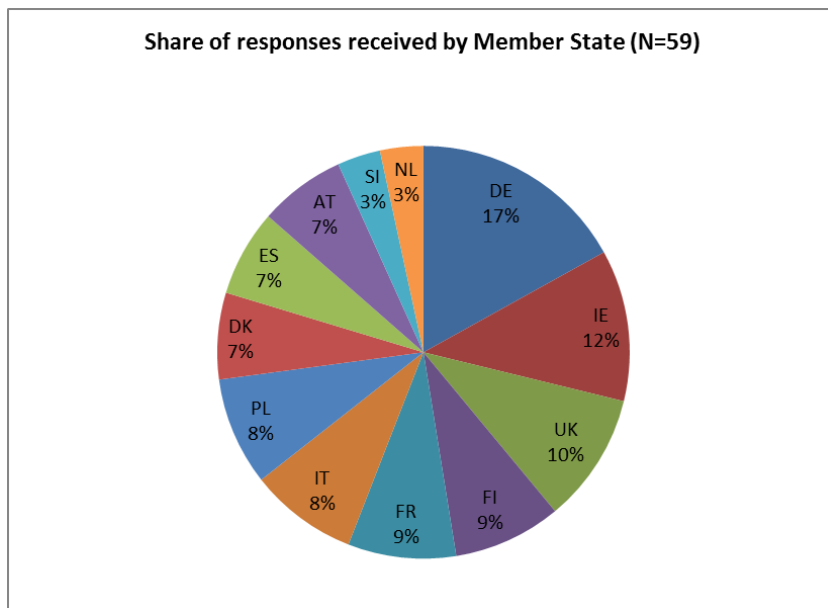
Part E was the largest part of the questionnaire and was exclusively addressed to industry respondents (insurance company, intermediary (including bank, retailer etc.) or trade association representing these professionals). It also contains separate sections for insurers and intermediaries. This part was subsequently separated into a standalone questionnaire for providers only in June 2013 creating a revised shorter "provider questionnaire".

Research responses and results

The survey questions were sent to all stakeholder groups throughout the geographical coverage of the research. It has to be made clear that the questionnaire was not designed to get a large amount of responses in order to be able to make statistical evaluations. The questionnaire was more designed in the way in depth interviews are made with experts. It was an attempt to achieve the cooperation of experts who were supposed to be sufficiently knowledgeable not only to draw an adequate picture on the situation in their country but also to provide the adequate evaluation. The methodology was comparable to the assignment of expertise to stakeholders and scientists who worked in this area. The quality of the information was therefore not guaranteed by statistical methodology but by the assessment of the consistency of their responses. In this respect the return rate of responses was in the range expected by the research team.

The number and detail of the responses received from the Member States are shown in the chart below.

Figure 46: Share of responses received from the MS covered



Below is a table showing the stakeholders that contributed significantly to inform the research. While a number of trade association representatives responded for the industry (insurance undertakings and intermediaries), individual intermediaries (firms and individuals) reached out, did not choose to respond with personal data. The survey responses were disappointing and did not improve with reminder emails and requests for contributions. A separate questionnaire for intermediaries was devised subsequently containing fewer questions, but this still did not bring the desired number of responses.

Table 30: Survey responses

		LEGAL EXPERT	REGULATOR	CONSUMER ADVOCATE	TA INSURER	TA INTERM.	PROVIDER (INSURER/INTERM)	TA OTHER	TU
	Total								
DE	10	1		2	1	1	4	1	
DK	4	1	1		1				1
FI	5	1	1		1		1		1
FR	5	1		1	1	2			
IT	5	1		1	1		1		1
IE	7	1	1	2		2	1		
PL	5	1	2		1		1		
SI	2	1		1					
ES	4	1		2			1		
UK	6	1		1		2	1	1	
AT	4					1	3		
NL	2		1	1					
TOTAL (MS12)	59	10	6	11	6	8	13	2	3

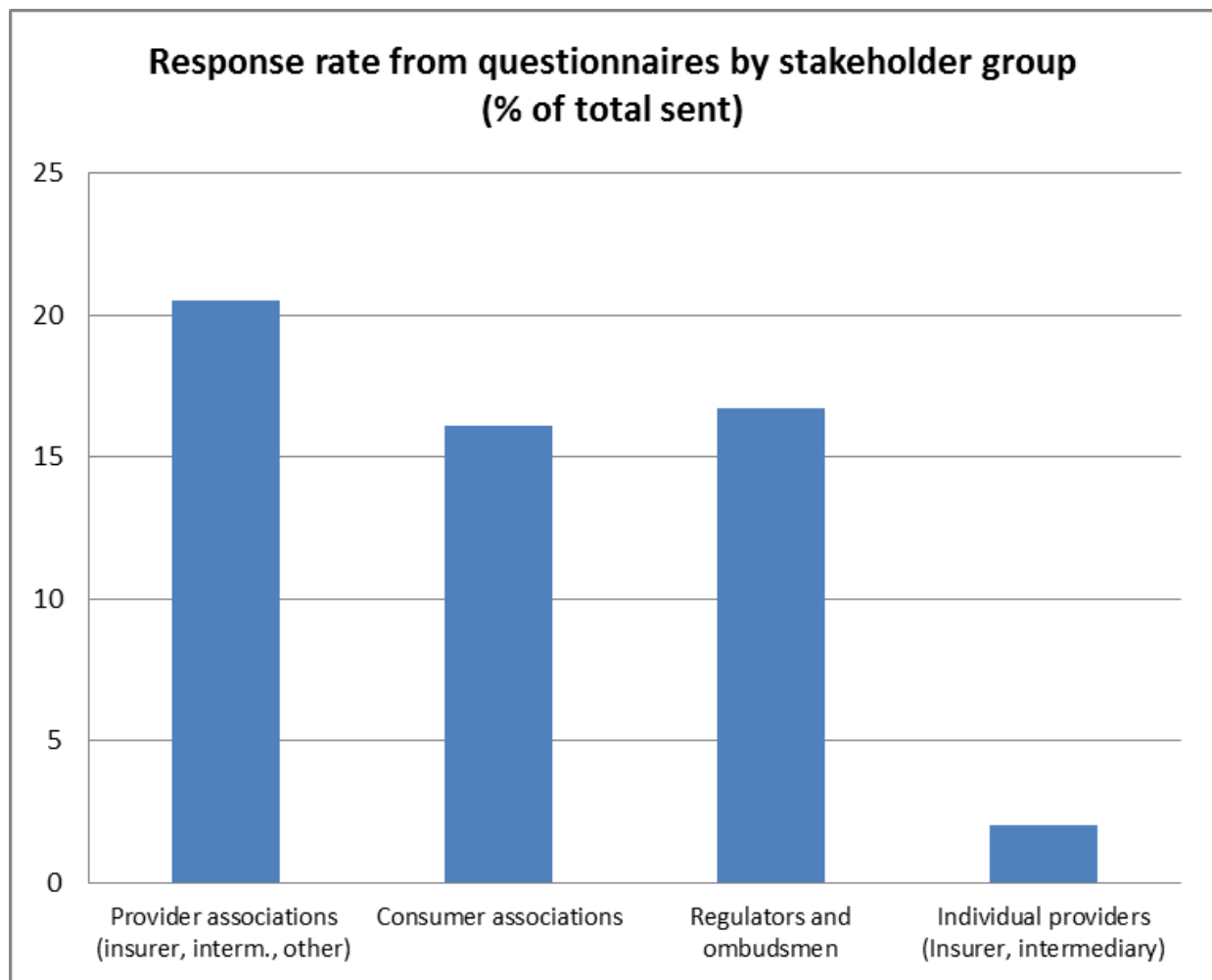
Note: TA = trade association; TU= Trade Union; Other respondents not featured in the table include: Norway, Slovakia, Romania, Australia, and respondents from the EU level.

Table 31: Number of questionnaires sent and responses received by stakeholder group for the 10 MS

MS	PROVIDER ASSOCIATIONS (INSURER, INTERM., OTHER, TRADE UNIONS)		CONSUMER ASSOCIATIONS		REGULATORS (INCL. OMBUDSMEN)		INDIVIDUAL PROVIDERS (INSURER, INTERM.)	
	INVITED	REPLIED	INVITED	REPLIED	INVITED	REPLIED	INVITED	REPLIED
Germany	9	3	4	2	2	0	77	4
Denmark	5	2	2	0	2	1	32	0
Finland	7	2	3	0	5	1	35	1
France	14	3	15	1	4	0	25	0
Italy	11	2	9	1	4	0	57	1
Ireland	9	2	4	2	4	1	86	1
Poland	7	1	6	0	3	2	27	1
Slovenia	2	0	3	1	2	0	45	0
Spain	13	0	9	2	2	0	71	1
UK	11	3	7	1	2	0	45	1
Total	88	18	62	10	30	5	500	10
EU Institutions	5	1	1	0	0	0	0	0
Austria	1	1	0	0	1	0	60	3
Netherlands	0	0	1	1	1	1	0	0

The results above show that survey responses from financial intermediaries or their relevant organisations were small (some reasons for this are outlined in the following section). Data collection from this stakeholder group is problematic without the involvement of a trusted authority that has the power to persuade them to do so. While the total number of intermediaries contacted by email is very high, the largest portion of these is made up of individual brokers selected randomly from the registers of intermediary trade associations. As small entities, it is fair to say that many of these may not have had the capacity to take the time to contribute answers. The response rates shown in the figure below must be relativized since the entities contacted included the above mentioned low probability potential respondents.

Figure 47: Response rate from questionnaires by respondent group



Note: N=690, for the 10MS excluding legal experts.

The intention was that the questionnaires addressed to the industry (insurers, intermediaries and their trade associations) would be able to provide some details on the range of commissions on the market etc. but little concrete data on the specific aspects of our study were shared by the industry. The reasons why the organisations may have refused to provide requested information are not always known. Often, in the case of trade associations representing the providers (whether insurance firms or intermediaries or banks), this was because they did not have the data available or not disaggregated in the form we would have wanted. Reasons for the low involvement of the industry in providing answers are manifold. Some of further explanation lies in external factors as well as suboptimal research procedures that were used. Below are examples of these factors:

Barriers to provider participation

Sensitive data: A severe limitation to our research was the sensitivity of the data being sought. Had the study focus exclusively on regulation, or exclusively on investigating the remuneration schemes the task may have been easier. Contractual and internal data is difficult to obtain and the trade associations have told us that they are themselves not privy to such competition-sensitive information. Details on remuneration paid, in its various forms, are part of the professional secret of banks and insurance companies, for example:

"We wish to remind that in compliance with the EU and national antitrust regulations, the trade Association is not entitled to collect and process information and data of commercial nature relating to insurance products or services of any type except for those useful to the drawing-up of studies and statistics that are admissible on the basis of the EU sector regulation. In any case the Association may spread the aforesaid information and data exclusively under an aggregated form." (Italy)

"In response to Your question on the study of intermediary remuneration we would like to point out that the Polish Chamber of Insurance (PIU) is not able to provide the required data. Please note that the required information/data are most sensitive (are business secrets) and PIU do not collect, process and analyse them. Our members haven't been and aren't interested in the sharing of such data. One of the PIU main tasks is to create all kinds of best practices documents. In this way, the PIU affects and creates a policy of remuneration systems." (Poland)

"We are sorry to inform you now that we are not in position to reply to the questionnaire prepared for the trade associations, since the Spanish Banking Association, in order to strictly respect competition rules, never intervenes on issues related to the policy on prices or remunerations used by their members. Accordingly, we have not any information on the practices of our members on such issues and it will be against our policy to ask our members to provide the information requested in the questionnaire." (Spain)

"Thank you for your email. I need to let you know that remuneration is not a matter we advise our membership on; or is an issue we are able to discuss with third parties. I am sorry we cannot help on this occasion." (UK)

"We haven't filled in the questionnaire as we felt that many of the questions we were unable to respond to because we either do not collect the information from our members or we are not able to provide the information on such a granular level. We also do not collect any information from our members relating to their forms and characteristics for financial rewards. This information is specific to each insurance company and is a highly competitive issue for them. We would not ask them for this information now or in the future." (UK)

Linked to the issue of confidentiality of data, was the fear that answers provided at firm level could be traced back to them if insufficient data was provided at national level by other firms to the research team for the study.

Trade association inability to assist:³⁶⁴ We expected the associations³⁶⁵ to be more willing and able to assist us in the research but this was not the case. While some simply told us to find the list of member organisations on their website and find contact persons there, most did say that they would pass our questionnaire on to their members. It is difficult to know exactly to what extent these member organisations received our survey as we were not part of the communication they had with them. Some trade associations however did return to us to inform us that a specific member is expected to respond, which was helpful to know as it allowed reminding this person later. E.g. even when the industry stakeholder was willing to cooperate they were not able to do so as shown by this response from the Danish Insurance Association:

"Thank for including us in your study. We in the Danish Insurance Association find it very interesting and we are very willing to contribute to you work as much as possible. Unfortunately we are not able to answer a lot of the questions in the questionnaire. Either we do not possess the knowledge to provide a thorough answer or the Danish competitive legislation does not allow us to collect the data. But we have answered the questionnaire as thoroughly as possible. And I hope that you will find our answers useful."

Sometimes the complexity of the questions and provider fear of being unrepresentative was the problem:

"we are afraid that the questionnaire is too detailed and too complex to be able to answer it thoroughly, even for us as representatives of financial agent + members of the Association of financial intermediaries and advisors. There is lack of valid data, and our market is not yet matured as far as details for remunerations are concerned. That is why the answers would be neither impartial nor objective. Sorry for not being able to be more helpful and cooperative." (Other MS)

³⁶⁴ This was however not always the case, the European Federation of Financial Advisers and Financial Intermediaries (FECIF) for example was helpful, and while not itself completing a questionnaire, it shared national contacts, time and insights and findings of two studies they had conducted (one on clients and their preferences and another on advisers about their income situation).

³⁶⁵ All Member States covered had some industry representative body as point of contact with the exception of Slovenia that does not have a trade association representing intermediaries.

Timing and context: The context with regard to the timing of the study (coinciding with the legislative activity at EU level regarding investments and insurance intermediation) was also a strong unfavourable factor that made an already difficult task even more so. The legal uncertainty, and the ‘fear’ that information provided by the product providers and intermediaries could be used against their interests, meant that potential respondents were reticent to assist us with our quest for illustrative data on practices. Reassuring these persons that the study was not linked to the political process and would time-wise not be able to influence deliberations did not seem to improve the chances of getting information from them. Below is an extract from a letter received from an insurance trade association as a response to our questionnaire that shows a couple of the weaknesses with the timing and the lack of explanations.

- Clarification request

First of all, it is not clear for us how the European Commission study combines with the current discussions about remuneration disclosure and conflicts of interest under IMD recast. We wonder whether this study is intended to prepare delegated acts or announces another text independently of the current IMD recast draft. Anyhow the intention of the European Commission should be clarified on this point.

Secondly, we feel very concerned about the unjustified suspicion concerning professionals that some views of the European Commission as well as some parts of the questionnaire (cf. questions 50 to 72, 141 to 149) are likely to show.

Cultural reasons: These also play a large part on the delicate subject of personal financial wealth and income situation. In France for example it is very difficult and uncomfortable for individuals to talk about details on how much they earn which reduces a source for insights into the market practices.³⁶⁶

Consumer focus of the survey: Often provider entities identified were not exclusively involved in business serving retail consumers but businesses which may have deterred some potential respondents from doing so, e.g.

“If I understand correctly, the study is concentrated on retail consumers and brokers who do business in connection with the retail consumers. With that being said, I must inform you that we do not do retail business, therefore the questionnaire is not applicable to us.” (Slovenia)

In addition certain banks contacted replied that they were not concerned by the study because the subject was retail insurance (although we tried to specify that the focus was on capital life and payment protection policies that do concern them).

Other difficulties

As mentioned above the price for the complexity of a questionnaire that aimed at a consistent knowledge of the respondents was the low return rate. With hindsight separate standalone questionnaires would have worked better and fewer questions (at the cost of broad stakeholder views on the range of issues) would have encouraged more respondents answering. But this would have been at the expense of the depth of its contents. The mixture of factual data and ‘opinion’ data being asked appears to have either confused potential respondents, or meant they preferred to only answer the questionnaire partly, e.g. this regulator:

³⁶⁶ The research results obtained by Christian Prantner for Austria in an annex effort to this Study are difficult to compare since it is a country that has already embarked on the road to discussing the issue of intermediaries and remuneration openly for some time and there have been a number of vocal persons and press articles that have made talking about details of commissions far more advanced as in other Member States.

“While filling the questionnaire we made a decision not to answer to the questions in Part D (Opinions). That is because the questions quite a lot relate to opinions “how the law should be like”. These questions we as a supervisor thought it would be suitable to leave to the legislator. Therefore, we sustained from answering these questions.”

But from the reactions to this questionnaire as such one can assume that the questions have been read and reflected quite carefully so that superficial responses are less feasible.

Other difficulties are:

- Inclusion of problem questions (Part B of the questionnaire), which may have provoked the potential industry respondents.
- The available timespan for such research was not sufficient. Considerable time was needed for groundwork to locate the entities and people concerned with and able to answer questions.
- In addition, the project did not allow for sufficient financing for the resource-intensive work involved in chasing up the entities contacted.
- While efforts were made to contact persons of interest referred to iff, some inefficiencies did occur. For example, a contact person and details provided to iff by the FSUG was inadvertently not contacted with the questionnaire as intended, while other suggested persons for Austria were not prioritised seeing the focus of the study did not directly include Austria among the 10 Member States.

Annex II: Persons involved in the research – Project team and legal experts

The project was led by Prof. Dr. Doris Neuberger (University of Rostock and iff Economics Research Director, economics) and Prof. Dr. Udo Reifner (iff research director, law and sociology).

The inner group of researchers further included: Dr. Roger Rissi, lic. oec. publ., FRM (University of Luzern, economics), Dr. Christine Riefa (Brunel University, law), as well as Christian Finger (PhD Student at Rostock University) and iff staff Michael Knobloch (law) and Sebastien Clerc-Renaud (project coordinator, economist). Support for desk research was provided by Cathryn Ulikowski and Georgi Ivanov.

The research team was able to count on the legal expertise of the persons listed in the table below who were able to inform the project with valuable answers regarding their respective Member State legislation and regulatory practice.

Table 32: List of the Legal experts who have contributed to the study

EU Member State	National Expert for law
Denmark	Tanja Jorgensen (Aarhus University)
Finland	Frey Nyberg (University of Helsinki)
France	Sarah Lespinasse (INC)
Germany	Michael Knobloch (iff)
Italy	Prof. Diana Cerini (Milan University)
Ireland	Mel Cousins, (Mel Cousins & Associates)
Poland	Dominika Wągradzka (bnt Neupert Zamorska & Partnerzy sp.j.)
Slovenia	Prof. Damjan Možina (University of Ljubljana)
Spain	Francisco de León (Ashurst LLP) and Juana Pulgar (Universidad Complutense de Madrid)
United Kingdom	Prof. Toni Williams (University of Kent)

Additional input was provided by AK Wien in the form of a mystery shopping exercise carried out in June 2013. The research team would like to thank Christian Prantner for his support and assistance in the carrying out of our research.