Working document

Packaged Retail Investment Products (PRIPs)

"Putting the needs and interests of consumers first"

Dutch Association of Insurers

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The Dutch Association of Insurers represents the interests of private insurance companies operating in the Netherlands. The Association's members represent more than 95 percent of the insurance market expressed in terms of gross premium income. The Association is an independent organisation managed and financed by its members.

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VERBOND VAN VERZEKERAARS

Key points Dutch Association of Insurers

The Dutch Association supports the efforts of the European Commission on Packaged Retail Investment Products (PRIPs). Within the Dutch Association, we put the needs and interests of consumers first. As a result of lessons learned in the Netherlands we call on the Commission to:

1. Create a framework that does not put not the products first, but the needs and interests of consumers. In that respect, the PRIPs-project provides an excellent opportunity to re-think and reshape the way consumers are supported by the European insurance industry;

2. Remove all remuneration bias (e.g. sales bonuses, product or provider biases, distribution and up-front lump sump fees) from the sale of retail investment products;

3. Provide consumers with information which allows them to compare similar products and make informed decisions for products originating in different sectors as well as in the same sector;

4. Take into account that, from a consumer point of view, PRIPs and IMD2 selling rules and product disclosures can not differ. Maximum harmonisation should not threaten the benefits that the Dutch consumers currently have under the new harmonised Dutch financial rules;

5. To deliver a framework where regulatory arbitrage (for example for remuneration) is eliminated.

Background: lessons learned in the Netherlands

1. During the last decade, the Dutch Association has undertaken major efforts to support the transformation of the Dutch insurance market, and the distribution system in particular, to create a sustainable market that focuses on consumer needs. In 2007, the “VerzekeraarsVernieuwen” (“Insurers Innovate”) project was initiated. This project is a coordinated effort of Dutch insurers to put consumer needs and interests in the first place in all their business.

2. With respect to remuneration, selling practices and product disclosures the key lessons learned are the following (chronological):

   - Remuneration and selling practices:
     i. Before 2006, self regulation with respect to transparency of remuneration of intermediaries was not effective in promoting good outcomes for consumers. Please note there was no regulation of intermediaries at all (except a registration requirement).
     ii. As from 2006, regulation of intermediary remuneration by introducing standardized transparency rules and requiring intermediaries to disclose their remuneration on the request of consumers did not work either. Therefore <u>we do not believe in “disclosure on request”</u> as some other stakeholders have proposed for the PRIPs regime. Due to mis-selling in the Dutch market, insurers have settled consumer complaints for app. € 5 bn.
     iii. As from 2007, there is a horizontal approach in the Dutch legislation. Regardless of the distribution channel through which advice is given to consumers: the level of consumer protection is the same.
     iv. In January 2009 a harmonised legislative regime regarding mandatory pre-contractual disclosure of remuneration and costs was established. MiFID is the benchmark.

- Product disclosures:
  i. Product disclosure on provider costs (introduced by the Dutch Association in 2008 for investment related insurances: “Models De Ruiter”) has proven to help consumers to compare these products and make informed decisions with respect to investment related insurances. This initiative of the Dutch Association was transformed into legislation on a cross-sectoral basis.
  ii. Introduction of a cross-sectoral information leaflet for all “complex products[1]” by the Dutch regulator Authority of the Financial Markets (AFM) has proven to be successful. Consumer panels have been engaged to develop and test this leaflet.

3. The confidence that consumers have in the Dutch financial sector is still weak. Factors contributing to this are high commissions, up to 80%, on mortgage and credit payment protection insurances and funeral insurances. Only very recently, in October of this year, a Dutch consumer bank went bankrupt due to high commissions in insurance products and the loss of consumer confidence. As result, there is a severe public pressure on the current Dutch distribution system and the relationship between intermediaries and product providers:

   i. The Dutch Prime Minister and the Minister of Finance warned the insurance industry to change its behaviour towards consumers;
   ii. The Dutch Parliament demanded a total ban on bonuses and launched the idea to put a cap of 15% on commissions for some products which are not sold properly or with aggressive selling practices.

A new Dutch era: Customer Agreed Remuneration

4. In June 2007, we asked the Boston Consultancy Group (BCG) to conduct a study on a possible scenario for intermediary distribution regarding life products: “complex products” and falling within the scope of PRIPs. BCG has taken consumer needs as the starting point of their study. BCG performed a fundamental analysis of the Dutch market and researched possible bottlenecks within the distribution system. Regarding selling practices BCG concluded that there are four major bottlenecks causing the imbalance in the Dutch distribution system:

   i. the position of the intermediary is not clear to the consumer. The intermediary has a conflict of interest (acting on behalf of the consumer and the product provider) which allows for product and provider bias;
   ii. there is no pressure from consumers to receive ‘good advice’;
   iii. insurance products are too complex for consumers to comprehend;
   iv. there is a low interest of consumers in insurance products.

5. In 2007, the Dutch Association developed a vision on the distribution of insurance products: Customer Agreed Remuneration (CAR). The Dutch CAR model is based on 10 key elements (such as clarity for the consumer, free market, agreed remuneration, avoiding even the appearance of conflict of interest, different types of remuneration) and implicates that:

   i. remuneration bias must be removed;
   ii. remuneration of an intermediary is agreed between consumer and intermediary without any involvement of a product provider;
   iii. remuneration of the intermediary is attached to services rendered by the intermediary, agreed by the consumer and laid down in a service agreement;

[1] Complex products are defined as a combination of two or more financial products of which the value of at least one of the products is dependent on the developments on the financial markets or other markets. This includes life, mortgages and second and third pillar pensions.

iv. product providers set the price of a product (factory price) upon which the intermediary can add the agreed remuneration with the client;
v. clarity on the roles and responsibilities of intermediaries and product providers is required: intermediaries are responsible for the advice whereas product providers are responsible for the product.

6. In May 2008 we have asked SEO Economic Research (University of Amsterdam) to conduct a study on the pros and cons on different remuneration ingredients[2]. This was in order to facilitate benchmarks and thoughts for sustainable remuneration models for life products (products within the scope of PRIPs). SEO concluded in their report on remuneration that Customer Agreed Remuneration is a logical step after full transparency of remuneration[3].

MiFID style rules at work in the Dutch insurance sector

7. We do not share the view that MiFID style rules are unsuitable for the insurance sector. As from January 2009, the MiFID inducement rules are applicable to "complex products" in the Netherlands. Furthermore, as from 2010 these rules will be applicable to payment protection insurance and funeral insurance. Some key features of the new legislation are the following:

- initial and trail commissions only;
- no bonuses permitted;
- mandatory pre-contractual disclosure of remuneration by intermediaries;
- mandatory information document on remuneration for consumers;
- mandatory pre-contractual disclosure of costs by product providers (in Euro's and not in percentages);
- level playing field agreed between distribution channels with respect to selling rules and product disclosures.

8. The Dutch regulator AFM has declared that Customer Agreed Remuneration model, introduced by the Dutch Association, is the ideal model to strengthen consumer confidence. The AFM has provided the market with guidance on inducement[4] based on CESR recommendations[5]. In 2009 the AFM stated that in an ideal situation the intermediary does not receive commissions from third parties but charges the consumer directly or passes the received commission on a one-by-one basis through to consumers.

9. The Dutch market is in transition. For nearly one year, the MiFID inducement rules have been applied to Dutch insurance products. There are positive developments in the behaviour of market participants. Bonuses are removed from commission agreements between product providers and intermediaries. Some intermediaries have already moved away from commissions towards fees. Mandatory documents on intermediary remuneration are provided to Dutch consumers. We are waiting on a first audit of the Dutch AFM, but it is clear that these developments are working in the benefit of the consumer.

Regulatory patchwork replaced by a horizontal approach

9. In our view the EC is adressing a legitimate issue by raising the question "is the regulatory patchwork a source of concern?". The Dutch Association recognises this concern. In the Netherlands horizontal legislation has been a success. Therefore we support the EC horizontal

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[2] The Dutch intermediary organizations NVA en NBVA were also involved.
[3] Please visit http://www.seo.nl/binaries/publicaties/rapporten/2008/2008-17a-remuneration_summary.pdf for a download of the summary of the SEO report "Remuneration: an insight".
[4] Please visit www.afm.nl for a download of the AFM guidance on inducements for financial services.
[5] CESR Recommendations "Inducements under MiFID", May 2007, ref. CESR/07-228b.

approach. The future framework on PRIPs should be a clear and unambiguous legislative regime. A horizontal approach to both mandatory disclosures and selling practices is the path to promote consistent outcomes in the interest of consumers. We would like to stress that in our experience only mandatory disclosures have been effective. Although we are fully aware that mandatory disclosures involve high costs for the industry, we consider this as an investment necessary to secure the reputation and the future of the insurance industry. Our focus is to create a trustworthy industry that plays a vital role in society serving consumer needs.

Scope of PRIPs: traditional life and pensions included

10. A right definition of PRIPs is crucial considering consumer needs and avoiding regulatory arbitrage. We urge the Commission to create a regime for equivalent regulatory treatment of equivalent products. Given the fact that markets are innovative, the PRIPs definition must be "future proof" as well.

11. Given the experiences in the Dutch insurance market we have established a broad economic definition for so-called "complex products". Based upon our experience we find it important to use a broad economic definition, rather than a legal form of packaging, that enables consumers to compare all life products. Therefore the Dutch insurance industry firmly believes that besides unit-linked insurance also classical or traditional life insurance should be included in the scope of the PRIPs definition. We present the following reasons:
    - Unit-linked life insurance and traditional life insurance both serve the same economic purpose (to accumulate capital) and should therefore be subject to similar regulation. An economical definition should determine the regulatory treatment of products and not the legal nature of the product.
    - Consumers must be able to compare products originated in different sectors (for example insurance vs. banking), but also between similar products originating from the same sector;
    - Intermediaries giving advice to consumers do include traditional life products in the range of products they advice. In some cases a consumer has to choose between traditional life and unit linked. It is therefore difficult to defend a position which does not allow transparency for products (classical life) which serve the same economic function. A consumer should be able to compare unit linked products and classical life products on a same format. Product disclosure rules and selling rules should therefore also be applicable to classical life products.

12. We urge the EC to include pensions under the scope of PRIPs. Nevertheless, we are aware that the issue of pensions deserves a closer examination. In the Netherlands pensions are falling under the definition of complex product and the MiFID inducements rules are applicable to second and third pillar pensions. This in order to avoid regulatory arbitrage. Furthermore, intermediary business models are structured in such way that it is not possible for a regulator to adequately supervise the ban on bonuses. Pensions provide a possibility to escape the PRIPs selling rules.

Product disclosure: mandatory pre-contractual information

13. We fully agree that product disclosure is more than essential in order to allow consumers to compare products effectively and to make informed decisions. We agree with the principles set out in box 2 of the EC communication. We support the Commission approach to use the Key Investor Information document for UCITS as a clear benchmark. In our view the information provided should at least include essential product information, be clear (no technical jargon), short and concise and delivered in a timely way (after orientation phase). For a better understanding by consumers there is evidence that is better to use Euro's instead of percentages to explain costs which are deducted from premiums.

14. We urge the Commission to develop a framework with mandatory pre-contractual information. In the Dutch market we have a horizontal approach on product disclosures. Horizontal rules are applicable and mandatory pre-contractual information disclosure is required. As from 1 January 2010 product providers in the Netherlands will have to disclose their costs on a cross-sectoral basis. Consumers receive information on what happens with their premiums. There is a breakdown in costs of insurers (initial and recurring), costs of distribution and risk premium. There is no sector-specific approach in the Dutch market and we do not support one at EU level.

15. Product providers and intermediaries are also required to provide the retail client with a financial leaflet. In this financial leaflet information in a fixed obligatory format is provided to the client in order to allow the client to compare products and make an informed decision taking into account the risks involved.

Selling practices: remove all remuneration bias

16. We support the horizontal approach to the regulation of selling practices. In our view MiFID is quite suitable as a benchmark for the insurance industry. We have almost a year of experience with the MiFID inducement rules for insurance products.

17. We urge the EC to remove all remuneration bias. Conflict of interests can arise due to the impact of commissions, bonuses and other incentives (such as luxury treatment of intermediaries). We believe that it is fundamental to move from a “product push” industry with remuneration bias towards a “customer pull” distribution model without bias. This means that we would like to put the customer at the heart of all our efforts and develop products that increase customers value. Therefore we urge the EC to seize the PRIPs opportunity to re-think the regulatory architecture and build one around the customer.

18. Due to the lessons learned in the Netherlands MiFID rules are the benchmark for our harmonized approach with respect to selling practices and remuneration for complex products. We support the principles in box 3 of the Communication on PRIPs. It is important that there is a consistency between PRIPs selling rules and the coming IMD 2 rules regarding the sale of non-PRIPs insurance products. From a consumer perspective it is difficult to explain that the issue of remuneration is dealt differently in PRIPs and IMD 2. When addressing the selling practices of non-PRIPs this issue of removing bias should be dealt in the same way as for PRIPs.