Position paper

Position on inducements

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The diversity of EU markets needs to be respected.

EU rules on inducements need to be workable in all EU markets. This includes markets that already have restrictions and transparency requirements in place, those with national rules on mandatory advice, and those markets where digital innovation is already leading to more online sales. The existing Insurance Distribution Directive (IDD) rules, with member state options, take the right approach, establishing a robust set of rules and enabling national governments to take further measures appropriate for their market.

For instance, a key difference between markets is the distribution structure (independent advice, tied advice, bancassurance etc) and the varying degree of importance which individuals place on private pension savings, which in some markets is dependent on the functioning of the underlying pension system. Ensuring access to financial markets and widely available advice is key to avoiding poverty in old age, which is a huge societal problem. In EU countries where social security pension systems have been reformed with less favourable terms for individuals, the need for sound financial advice will continue increasing.

Widely available, high-quality advice has a positive impact on consumers

Consumers regularly indicate that they make investment decisions based on the expertise provided by their advisors. 2022 Eurobarometer data indicated that 45% of respondents make decisions based on the advice from their advisors[1]. Similarly, a 2022 Global Consumer Study by Remark Group found over half of respondents sought out advice from professional advisors[2]. This is backed up by the EC's own external study on disclosures, inducements and suitability which found that consumers trust and rely on the recommendations provided by their advisor[3].

In many markets, the commission system is an integral and indispensable part of the distribution system for retail investment products, without which the number of and access to intermediaries and, therefore, consumer choice, would be significantly curtailed. Given the diversity in how insurance is distributed in different national markets, a ban on inducements as applied to other sectors by the Markets in Financial Instruments Directive (MiFID II) would not be appropriate for the insurance sector. The minimum harmonisation approach taken in the

[1] Retail Financial Services and Products - October 2022 - Eurobarometer survey (europa.eu)
[2] The Global Consumer Study: Insurance trends, analysis - ReMark (remarkgroup.com)
[3] Disclosure, inducements, and suitability rules for retail investors study - Publications Office of the EU (europa.eu)

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IDD allows EU member states to restrict or ban the use of commission where appropriate for their market but to permit its use where it is helpful in enabling access to financial advice, preventing the emergence of "advice gaps". The IDD was deliberately designed as a minimum harmonisation regime, with legislators not seeking to override existing national differences or pre-suppose that a one-size-fits-all approach would be effective. Indeed, several member states have made use of this option to introduce further restrictions where appropriate for their market, for example in the form of further information requirements, mandatory advice or a full ban on payment of commission depending on each market's specific features and needs.

In some member states, the commission-based distribution system is useful in providing for a level of financial education and awareness. This includes the importance of pension saving and risks arising from pension gaps specific to people's own circumstances that they would otherwise potentially not have a full picture of. It is helpful to make people aware of their need for old age provision, even before they recognise their demand for this intrinsically. In contrast to this, fee-based models presuppose this knowledge of pensions and insurance gaps.

Where 'advice gaps' emerge they are likely to have a disproportionate impact on vulnerable (such as those with below average incomes or low financial literacy) or geographically isolated consumers and are likely to restrict the availability of advice more significantly for consumers with lower amounts to invest. Difficulties will be even more intense in markets where execution only sales of insurance-based investment products (IBIPs) are not permitted. Poor access to advice ultimately damages consumer confidence and inhibits access to financial markets.

Payment for advice is necessary either via commission or fees

Commission is not an unnecessary expense and reflects the price of the advice and other distribution services provided to the client. This can include any assistance provided by the intermediary to the policyholder in the administration and performance of the insurance contracts, in particular in the event of a claim, as set out by the IDD. The commission-based system is one way of funding the costs of providing the advice to the customer. Where advice is provided but commission is banned, the customer must pay for the advice in a different manner (usually a specific fee, or subscription model, or in instalments over a certain period). The commission system remains, however, the most prevalent way of remunerating distributors across the EU and is the dominant system in the majority of markets. This allows customers to access as much pre-contractual advice as they need free of charge, as this is effectively pre-financed by existing insured customers. This increases the affordability of advice, which is particularly important in markets with low levels of financial literacy. In many markets, the insurance distribution system still relies to a large part on face-to-face advised sales.

There is a perception that payment via commission will always lead to a conflict of interest and, therefore, is inherently bad, but this is not at all the case. In fact, it offers a mechanism for the financing of high-quality advice, making it available to consumers regardless of their financial status or literacy level and supports those consumers who are in most need of financial advice but who cannot afford it.

Several recent studies have highlighted drawbacks of commission bans

The EC external study on disclosures, inducements and suitability found that, where commission has been banned or severely restricted, the overall impact has been a shift towards execution only and online platforms.[4] Direct payment for advice has remained minimal. This builds on an earlier study by KPMG, which found that consumers in the German market were unwilling/unable to pay the cost of advice at the time of receiving advice.[5]

[4] Disclosure, inducements, and suitability rules for retail investors study - Publications Office of the EU (europa.eu)
[5] The future of advice - KPMG AG Wirtschaftsprüfungsgesellschaft

A similar trend can be seen in the fund management and banking markets. MiFID II provides for a full ban on inducements for independent advice, but permits the use of commission to fund 'non-independent' advice. In markets where national regulators allow for the payment of commission, there has not been significant growth in the uptake of independent advice. Instead, consumers continue to opt for non-independent advice or execution only. Similarly, in ESMA's 2020 Technical Advice on inducements, costs and charges under MIFID, ESMA did not recommend a complete ban of the inducements as a policy option to the EC.

The experience in the United Kingdom demonstrates a direct link between payment for advice and advice gaps. Since the UK introduced a full ban on the payment of commission for retail investment products, access to advice for consumers has become much more restricted. The UK FCA found in its 2021 Consumer Investments Strategy and Statement that 'financial advice is not reaching all parts of the market'. Half of UK adults with £10,000 or more of investible assets (around 8.4 million people) had not received any formal support to help them make investment decisions over the preceding 12 months. Moreover, only 8% of UK adults received financial advice and only 1.3% of adults made use of online robo-advice[6]. Open Money research from 2021 estimated that fewer people than ever are taking paid financial advice in the UK, with one in fourteen people (7%) having paid for advice in the previous two years[7].

Similarly, a 2021 study found a collapse of the financial advice industry in Australia, where a ban was introduced, with nearly 15% of advisers exiting the industry and remaining players facing immense margin pressure and, worse, needing to address the significant trust deficit. The result has been the creation of a significant advice gap, with many Australians unable to access advice in an economical manner. The study estimates that that only 1 in 10 Australians received advice.[8]

Advice is important in supporting consumer decision making and improving consumer understanding of economic conditions such as the mechanisms of pension systems, current interest rates, taxation, inflation, sustainability issues, but also the products consumers are buying. In instances where legislation dictates that this must be paid for directly when receiving advice, consumers are increasingly unable to access this important service, even more so in times of rising inflation as households generally have less money at their disposal. An adaptation to how advice is provided would fundamentally change the market, with the risk that the topic of insurance could fall into the background. Hence – as previously mentioned – the affordability of advice must be guaranteed across the EU, and this is particularly important in markets where low levels of financial literacy exist.

In addition, the newly implemented rules on the topic of sustainability entail a considerable need for explanation and advice. Terms introduced by regulation such as "explanation of whether, and, if so, how a financial product considers principal adverse impacts on sustainability factors" needs to be explained to be understandable for consumers. This explanation succeeds best in dialogue with a well-trained advisor who can meet with the customers knowledge and expectations[9].

IBIPs serve a specific purpose and are valued by consumers

IBIPs are not interchangeable with other investment products and must not be treated as such. As stated above, within the current economic environment, IBIPS are the principal retail financial instruments capable of creating capital for individuals who do not possess enough wealth to have access to sophisticated asset management opportunities. Customers of IBIPs tend to have a longer-term investment outlook and value security as highly as investment returns. Customers tend to buy IBIPs as part of their long-term financial planning. In this context many value having the opportunity to access expertise and advice. Based on an OpinionWay consumer study for

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[6] Consumer Investments: Strategy and Feedback Statement | FCA
[7] https://www.open-money.co.uk/advice-gap-2021
[8] https://www.oliverwyman.com/our-expertise/insights/2021/jan/future-of-financial-advice.html
[9] A TU Munich behavioural economics analysis showed that the "ESG term" is abstract and complex for many consumers. This is where clarification is needed. (Page 4; Item 5)

France Assureurs (2021), French retail investors expect three elements for their savings: security (41%), flexibility (40%) and return on investment (13%).

Dramatic changes in the regulation of the distribution of IBIPs risks not only restricting access to advice, but also restricting access to these important products, as the advisors who provide access to these products will be forced out of the market.

Simple transparency requirements can improve consumer protection

Transparency of inducements has been shown by the EC external study on "Disclosures, inducements and suitability" to have a limited impact on consumer decision making at the point of sale. However, there is potential for a simple and well calibrated transparency regime to enhance consumer protection by shining a light on potentially harmful practices and unreasonably high commission levels. Transparency can still be a useful tool in ensuring the payment of commission does not lead to consumer detriment and in empowering consumers to take a decision on an informed basis.

Given the importance of consumer protection, the impact of any new regime would need to be subject to appropriate consumer testing before it is introduced in order to ensure the information provided is understandable and of use to consumers. Transparency requirements would also need to go hand-in-hand with the consideration of the principle of 'value for money' at the product development stage.

The IDD and PRIIPs regimes already provide for a high degree of transparency, however this could be enhanced to strengthen customer confidence in retail investment advice. Right at the first contact with an insurance intermediary, customers should be informed of how this intermediary is remunerated. This will enable them to better assess the intermediary's interests. Transparency requirements should remain simple, in order to avoid overloading consumers with too much information[10]. For retail investment products, the commission an intermediary will receive should be disclosed to the customer, upon request, as a monetary figure or percentage. In line with the minimum harmonisation approach of the IDD, member states may maintain more stringent provisions, including additional restrictions as envisaged by Articles 22 and 29 IDD, where local conditions make it appropriate.

If disclosure of the commission to be received, is not possible, for example because it is too early in the customer journey, then the method of calculation needs to be properly explained. It is not always possible to disclose a precise amount of commission in Euros or as a percentage at the point of sale. The level of commission to be paid can vary based on a variety of factors and while aspects such as the amount to be invested or the product chosen are known, other factors related to the distribution are not. This is particularly true of multi-option products (MOPs).

In all cases, it is important to ensure a level playing field between all types of insurance intermediaries.

Proper enforcement of product oversight and governance rules offers a high level of consumer protection through the lifecycle of the product

The IDD product oversight and governance (POG) provisions are a detailed and robust set of rules that ensure products are well-designed and meet the needs of the customers for which they are intended. The recent EC external study on disclosures, inducements and suitability found that this system works, with the mystery shopping exercise demonstrating that customers were consistently offered a product that meets their needs. These rules have been supplemented by several additional supervisory actions, clarifying their application and

[10] As evidenced by IVW-Q-PERIOR-Paper-2_27102022_.pdf (unisg.ch)

supporting the industry in implementation. POG already requires that a distribution strategy is established. Where POG rules are enforced rigorously, they provide a series of safeguards for consumers that serve to prevent consumer detriment and to identify and rectify product design features. This process should already capture conflicts of interest that arise as the result of the remuneration structure paid by insurers and provides strong safeguards. Distributors must also identify and rectify problems that emerge with how the product is distributed.

Introduce value for money principles for PRIIPs in Level 1

Introducing high level principles on value for money for the product design of all PRIIPs in the Level 1 IDD and MiFiD II Directives would represent an additional safeguard to prevent the distribution of products that do not fully meet the target market's needs, objectives, and characteristics: for example, because the level of costs is not proportionate to the benefits and services offered.

IBIPs can offer a variety of features and benefits (eg financial guarantees, risk mitigation techniques, biometric risk covers, services, sustainability aspects etc) to meet different customers' needs and preferences, and their risk propensity. Accurately capturing the impact of these features requires proportionality in the application of the value for money concept. Therefore, the value for money principles should be flexible and take a holistic view on all the quantitative and qualitative aspects of the product. In particular, insurance features are not add-ons but an integral part of IBIPs. The client derives value from the product as a whole. For example, the existence of biometric risk cover, risk mitigation techniques and/or guarantees can be decisive factors in consumers' choice and can play an important role in mitigating clients' risks and losses. Therefore, the value for money concept should respect the distinctive nature of IBIPs.

In line with product manufacturers' freedom to set prices, the aim of the value for money principles should not be to introduce caps, nor fixed, quantitative thresholds. The introduction of a benchmark would see products clustering around that price, with providers focusing on lowering costs rather than the quality of their products. Lower costs do not necessarily mean better products for consumers, since such products could have large exclusions, expose consumers to higher risks or offer a reduced service.

Instead, the confidence of retail investors is strengthened by transparency about the impact of total costs on the return of the recommended product.

Once value for money is considered and tested by the product manufacturer in the product design, there is no need to repeat the assessment in the advice process. Distributors can rely on the product manufacturers' expertise in designing products and keep the sales journey simple and agile, in line with consumers' expectations.

Increased financial literacy could help address remaining conflict of interest concerns

The recent EC external study on disclosures, inducements and suitability found that financial literacy in the EU is overall low. While this is a reason why access to professional advice is so important, increased investment in financial literacy in Europe would be helpful to achieve a situation where all citizens have a basic understanding of financial services and markets. This could result in more empowered customers that are able to raise questions, know where and how to seek advice, challenge the advice given and better understand disclosures made.

Insurance Europe fully supports the Commissioner's remarks that "we should empower people so they know how to navigate their finances. The earlier in life that we build up financial awareness, the better... [Financial literacy] must go hand in hand with a well-regulated financial system, fair advice and good consumer protection — but it is a key part of the puzzle.”[11]

The nature of execution only sales in the IBIPs market must also be considered

The sale of IBIPs on a truly execution only basis is very limited. In some markets mandatory advice requirements make this impossible, in others while such sales are permissible the market is very underdeveloped. Where execution only sales do occur, it is still proportionate for a small amount of commission to be charged. For all sales, a demands and needs test must be carried out and a significant volume of precontractual information needs to be given regardless of whether advice is provided. This is a process that entails some costs for the distributor that would still need to be remunerated.

In many markets the use of execution only sales is primarily (or even solely) a technicality. This occurs where the customer cannot or will not provide sufficient information to perform a full suitability assessment, but still wishes to proceed with the sale. In these instances, a substantial amount of work will have been carried out by the distributor, despite the sale technically having been made without advice. With this in mind, a requirement that the commission received is proportionate to the level of service provided is the best way of ensuring consumer protection for execution only sales.

[11] Improving financial literacy must be a priority for Europe | Financial Times (ft.com))