



EIOPA-IRSG-12-02

31 January 2012

**FEEDBACK of the EIOPA Insurance and
Reinsurance Stakeholder Group regarding
EIOPA Consultation on Draft Report on
Good Practices for Disclosure and Selling of
Variable Annuities**

(EIOPA-CP-11/007, 27 October 2011)

EIOPA INSURANCE AND REINSURANCE STAKEHOLDER GROUP – OPINION

CONSULTATION – DRAFT REPORT ON GOOD PRACTICES FOR DISCLOSURE AND SELLING OF VARIABLE ANNUITIES –
JANUARY 2012

Table of Contents

Introduction and legal basis: 3

General observations regarding EIOPA EIOPA consultation on Draft Report on Good Practices for Disclosure and Selling of Variable Annuities: 3

Specific observations regarding EIOPA draft guidelines on Draft Report on Good Practices for Disclosure and Selling of Variable Annuities 7

Introduction and legal basis:

In October 2011, EIOPA initiated the public consultation on the Draft Report on Good Practices for Disclosure and Selling of Variable Annuities.

Variable annuities (VAs) are unit-linked life insurance contracts with investment guarantees which, in exchange for single or regular premiums, allow the policyholder to benefit from the upside of the unit but be partially or totally protected when the unit loses value.

Guarantees entailed in VAs can vary considerably and imply an increase of risks for insurers relative to pure unit-linked product; insurers have managed those risks in different ways which have varied across time, countries and market players. A common business model for EU VAs features relevant cross-border as well as group aspects: usually VAs are sold by large insurance groups either by their local subsidiaries or by specific subsidiaries dedicated to that business underwriting in several Member States, through freedom of establishment or freedom of services. This Report summarises the findings of an Expert Group, set up in May 2011 under the auspices of EIOPA's Committee on Consumer Protection and Financial Innovation (CCPFI) with the aim of establishing good disclosure and selling practices for variable annuities (VA).

The main findings of the Report are that good practices:

- in relation to disclosures
 - should provide general information on the insurance undertaking and the legal and supervisory regime it operates under to take account of the cross-border nature of this business
 - should also include product specific information to address product complexity
- in relation to selling practices
 - should ensure that variable annuities are always sold on an advised basis, even when they are sold directly by the company
 - should focus on the customer's objectives to determine his demands and needs.

The EIOPA Insurance and Reinsurance Stakeholder Group competence to deliver a feedback statement towards EIOPA consultation on the Draft Report on Good Practices for Disclosure and Selling of Variable Annuities is based on Article 37 of EIOPA Regulation (1094/2010/EC).

General observations regarding EIOPA consultation on Draft Report on Good Practices for Disclosure and Selling of Variable Annuities:

- The Workstream (WS) welcomes the opportunity provided by EIOPA to comment on its draft report on good practice for the disclosure and selling of variable annuities. The WS supports any initiative aimed at reinforcing consumer confidence and protection across the European Union.
- The WS has various comments to make in support of this initiative, particularly where it seeks to identify and promote good practice and increase meaningful information to customers. Variable annuities can be attractive products, particularly in an environment where planning for retirement provision is even more critical. It is also important that customers are targeted effectively and that relevant and appropriate information is given through all distribution channels. It is hoped that similar good practices can be developed in other areas as raising standards and enhancing consumer protection are critical consumer issues across a range of products.

EIOPA INSURANCE AND REINSURANCE STAKEHOLDER GROUP – OPINION

CONSULTATION – DRAFT REPORT ON GOOD PRACTICES FOR DISCLOSURE AND SELLING OF VARIABLE ANNUITIES –
JANUARY 2012

- **CLARITY.** The WS does feel that additional clarity is required from EIOPA regarding various aspects:
 1. **Definition of Variable Annuities.** While EIOPA has explained that the exact definition of Variable Annuities concurs with the classical definition as articulated under the CEIOPS' regime, we feel EIOPA needs to emphasise exactly what the definition covers, as some WS members felt the commonly understood definition may be too broad (basically comprising all unit-linked products with guarantees and therefore also products that do not fall under the technical definition of VAs)
 2. **The role of best practice.** While welcoming the role that good practice could play in raising standards, particularly where helpful case studies might be employed, some WS members felt more thought needed to be given to the legal implications and impact of good practice. Some felt firms would need much more clarity around how such an EIOPA report would impact on their firms and what EIOPA's expectations would be on them. EIOPA has explained that this initiative is not seen as either guidance or firm recommendations, but further clarity from EIOPA would be helpful. It is not clear how EIOPA's report could be developed into European industry standards or codes and how these would be monitored by competent national authorities. The WS would welcome further clarification on this aspect in EIOPA's final report. We also wonder how the supervision, policing and enforcement of certain rules would be undertaken in practice.
 3. It was also felt with regards to the role of best practice that legal uncertainties should be addressed in two dimensions: legal uncertainties as a consequence of best practice and in the context of other regulation, as it is explained under "general comments", and on top legal uncertainties due to the fact that the FAQs are being meant as only indicative: the FAQs would come on top of other legal and regulatory requirements, especially on top of the KFD acc. to IMD/ PRIPs. This also leads to legal uncertainties, on top of the unclear legal character of FAQs (therefore heterogeneous risk for civil liability for potential incomplete or misleading content across the member states).
 4. **How this initiative coincides with the EU Commission's work on PRIPS and IMD and how work is aligned to avoid duplicate or contradictory requirements.** Simplicity and clarity are desirable, both from an industry and consumer perspective. While EIOPA has explained that there should be no conflict with PRIPS and IMD, it would be helpful if EIOPA could articulate clearly why this is the case and where and how this initiative aligns with the EU Commission's work and responsibilities.
 5. **The definition of advice.** WS members felt that the nature of advice differed throughout the EU and that greater clarity was required around the definition, given European anomalies. This potential confusion clearly impacts on EIOPA's views on variable annuities and so clarity is required to ensure common understanding.

As the WS is not required by EIOPA to reach a consensus or majority view, but is free to express where it had different views, we felt it would be appropriate to highlight certain key aspects in this section of our response.

- **Should VAs only be sold on an advised basis?**

WS members did **not** agree on this matter, with the industry and intermediary members disputing that advice should be mandatory, while consumer and trade union members felt advice was necessary given the nature and critical importance of the product. There were also

EIOPA INSURANCE AND REINSURANCE STAKEHOLDER GROUP – OPINION

CONSULTATION – DRAFT REPORT ON GOOD PRACTICES FOR DISCLOSURE AND SELLING OF VARIABLE ANNUITIES – JANUARY 2012

views that, while advice should be given and encouraged, this should not be mandatory. The different views are given below:

- **Those supporting advice**

1. Variable annuities should be sold on an advised basis only. It is important, moreover, that advisers have the necessary expertise, professional qualifications and up to date knowledge to give informed advice. Whereas complexity of product structure does not necessarily require advice, these are complex product in terms of consumer understanding, risk profile and the nature of the outcomes. This means that while consumers may be attracted by the downside guarantee, other product features may not be so clearly understood. That is why we believe advice is critical. Although consumers incur a cost in obtaining advice, we believe the financial risk from buying without expert advice is potentially much greater – so we believe the benefit of the advice outweighs the cost of incurring that advice. Neither do we agree with the view that because advice is necessary this would inhibit choice or innovation. Indeed, it can be argued that it is far more important to ensure consumers get the most appropriate products for their particular needs and situation. Increased choice and rampant innovation are not always to the benefit of consumers.
2. It is also critical to ensure customers are aware of how advisers are being remunerated to ensure consumer interests are protected and that there is full transparency around costs, charges and any bonus or commission being paid. One additional suggestion would be to require that any brokerage/commission charges or changes in administration costs are required to be shown on policy declarations and annual statements. Additional payments made by the insurer could also be prohibited.
3. Variable annuities should be sold in a global context which fits with their complexity, long term character, financial risk, and aim really pursued by the customer. To cope with that, skilled and sound advice has to be provided. In order to achieve that, three parts have to be developed:
 - The quality of information available to the customer which depends directly on the working conditions in which the adviser/seller operates, and more specifically the time dedicated to the advice operation
 - A common playing field in the European Union in matters of qualification for the advisers/sellers with a consistent level to be reached, ensuring that any harmonisation does not lead to any downgrading of desired or applied qualifications in any country
 - Disclosure upon the variable part of the remuneration of the sellers whatever the channel of distribution could be, implying compulsory collective agreements in circumstances where remuneration is based on selling targets or inappropriate incentives to sell are being used
 - Alignment between the financial products of financial institutions and insurance is also necessary
4. While consumer detriment regarding may not have been evidenced, it is important given EIOPA's consumer protection agenda that it is alert to potential detriment. Adopting advised sales may help prevent detriment. It is also vital that there are realistic

EIOPA INSURANCE AND REINSURANCE STAKEHOLDER GROUP – OPINION

CONSULTATION – DRAFT REPORT ON GOOD PRACTICES FOR DISCLOSURE AND SELLING OF VARIABLE ANNUITIES – JANUARY 2012

expectations of customer understanding of risk as it relates to outcomes, given that these are not basic products.

- **Supportive but not mandatory**

VAs are best sold on an advised basis and because of their complexity should be sold with “advice”. However we do not think that it is appropriate for “advised sales” to be made mandatory. This is too prescriptive. Currently most VAs are sold on an advised basis and we question if there is any evidence that where problems have been identified, a disproportionate percentage of the problems have stemmed from non-advised sales. We believe that taking a “nanny state” approach will lead to reduced choice for consumers, greater costs and no appreciable benefits. Quite the opposite - it has the potential to give consumers a false sense of security which will result in their “dropping their guard”.

- **Those not supportive of advised only**

1. EIOPA appears to be proposing the sale of all variable annuities on an advised basis only. Linking the notions of complexity and the level of risk to the consumer may unnecessarily prohibit the sale of certain products to consumers on a non-advised basis. This may impede innovation within the market and consumer choice. Consumers do not always need or request advice. Therefore, it is important to ensure that the non-advised sale of insurance products in certain situations remains possible, such as when requested by the customer or where there is a low risk to the consumer. The consumer should remain of course always free to seek advice, but advice should not be imposed when specifically declined by the customer. It is crucial that non-advised sales may continue, so as not to limit or interfere with consumer choice, and to prevent restricting a consumer’s ability to access products if advice were mandatory and he/she were not in a position to afford such advice. In any case, it should not be forgotten that even in the case of non-advised sales, all relevant pre-contractual and contractual information requirements will still be followed.
2. Taking changing consumer attitudes toward sales habits into account, any such restriction would restrict consumer choice and accessibility of products and perhaps result in VAs not being sold at all in the future. This might hamper potential future product development. With advised sales only, products tend to get more expensive and perhaps unattractive.

- **References to Risk and complexity**

WS members also felt the report would benefit from more clarity around references to risk and complexity. Members were agreed that products which were complex in terms of their composition did not necessarily pose greater risk to consumers and that consumers did not necessarily need to understand the complexity of the product’s components. Members agreed what was far more important for consumers to understand was the likely outcome of these products and their returns including their volatility and risks for getting the expected/promised returns, but this again led to some divergence of views amongst the WS members, as outlined below:

- **Differing views**

1. Some members were concerned about the extent to which the draft report confuses the issue of the complexity of variable annuities with the level of risk to the consumer. Complex products do not necessarily mean high risk for the consumer. The interaction between the

EIOPA INSURANCE AND REINSURANCE STAKEHOLDER GROUP – OPINION

CONSULTATION – DRAFT REPORT ON GOOD PRACTICES FOR DISCLOSURE AND SELLING OF VARIABLE ANNUITIES –
JANUARY 2012

level of risk to the consumer and the complexity of the product needs to be properly taken into account. While variable annuities may employ relatively “complex” structures, particularly with regard to the guarantees offered, this does not necessarily result in risk for the consumer. In fact, complex structures are often aimed at delivering less risky outcomes for investors. It should also be pointed out that the risk associated with offering guarantees in variable annuities is borne by the insurer, not the policy holder, and the report provides no evidence of these products resulting in consumer detriment.

2. Even sophisticated consumers, for whom Variable Annuities are likely to be attractive products, may find the levels of risk difficult to understand, particularly where advice is not given. While the complex components of these products may not need to be understood by customers, it is essential that advisers explore risk profiles and customer needs to ensure these products are appropriate for their intended market. It is not appropriate for the industry to assume that consumers will understand risk and be able to compare risk, as so many financial capability studies have demonstrated. To put this onus on to consumers is inappropriate
3. Risks connected with the structures behind the product are already handled in Solvency II. Any additional requirements towards consumers concerning these risks would put the envisaged Solvency II regulations and its efficiency, already prior to their implementation, into question and comingle risks for the insurer with risks on the consumer side.

Specific observations regarding EIOPA draft guidelines on Draft Report on Good Practices for Disclosure and Selling of Variable Annuities

Feedback statement with regard to 15 specific questions asks during the consultation of Draft Report on Good Practices for Disclosure and Selling of Variable Annuities is provided in the comment template attached below.

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Adopted by the EIOPA Insurance and Reinsurance Stakeholder Group at Frankfurt am Main, 31 January 2012.

The Chairperson of the EIOPA Insurance and Reinsurance Stakeholder Group

Michaela KOLLER

EIOPA INSURANCE AND REINSURANCE STAKEHOLDER GROUP – FEEDBACK

CONSULTATION ON DRAFT REPORT ON GOOD PRACTICES FOR DISCLOSURE AND SELLING OF VARIABLE ANNUITIES – JANUARY 2012

Comments Template on EIOPA-CP 11/007 Draft proposal for Report on Good Practices for Disclosure and Selling of Variable Annuities		Deadline 03.01.2012 12:00 CET
Company name:	
Disclosure of comments:	EIOPA will make all comments available on its website, except where respondents specifically request that their comments remain confidential. <i>Please indicate if your comments on this CP should be treated as confidential, by deleting the word Public in the column to the right and by inserting the word Confidential.</i>	Public
<p>The paragraph numbers below correspond to the questions raised in the grey boxes of EIOPA Consultation Paper No. 11/007.</p> <p>Please follow the instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ <u>Do not change the numbering in column “Reference”, or any other formatting in the file.</u> ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a question, keep the row <u>empty</u>. Please do not delete rows in the table. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific question numbers below. <ul style="list-style-type: none"> ○ If your comment refers to multiple questions, please insert your comment at the first relevant question and mention in your comment to which other questions this also applies. <p>Please send the completed template to CP_007@eiopa.europa.eu, in MSWord Format, (our IT tool does not allow processing of any other formats).</p>		
Reference	Comment	
Q1.2. 3. 4.	The WS supports the development and use of key features/key facts documents as an aid to focus the potential purchaser’s attention on the most important factors that will enable him or her to take an informed decision. The WS believes that buyers of VA should be provided with sufficient and clear information to make informed decisions about	

EIOPA INSURANCE AND REINSURANCE STAKEHOLDER GROUP – FEEDBACK

CONSULTATION ON DRAFT REPORT ON GOOD PRACTICES FOR DISCLOSURE AND SELLING OF VARIABLE ANNUITIES – JANUARY 2012

Comments Template on EIOPA-CP 11/007 Draft proposal for Report on Good Practices for Disclosure and Selling of Variable Annuities		Deadline 03.01.2012 12:00 CET
	<p>the purchase of the product, including downside risks of variable annuities, complex charging structures and all/ultimate costs.</p> <p>The WS agrees that the content of information should be appropriate for targeted customers and that too much information is of as much concern as too little information. Customers should not be weighed down with too much technical information.</p> <p>Given the level of cross-border sales of variable annuities it is important that there is absolute clarity about the identity and nationality of the underwriter and the mechanisms in place for and any limits on redress and compensation in the event that things go wrong.</p> <ul style="list-style-type: none"> • One WS member believes that effective disclosure, however, while welcome is not a panacea and should not absolve the industry or advisers from effective targeting and sales of these products. This is why advice is necessary and over reliance on information is misplaced. • One WS member argued that any increased information requirements for cross-border business would contradict the basic EU-target of a single European market and constitute a clear obstacle to cross-border business and perhaps even impede VA offering as a result. “Cross-border” does not mean “heightened risk”. This would contradict also the European passport idea. The fact that VAs in Europe very often are sold cross-border is by the way a consequence of lack of adequate national accounting practice (GAAP) and tax rules, e.g. for hedging and “valuation units” in some EU Member States. • Both in the IMD and in the MIFID but also in the life assurance directives, there are clear rules on pre-contractual product disclosure which can arguably lead to increased cost for the customer. In various national markets the industry or the industries together with supervisors have built upon information systems which facilitate the comparability of offers in function of the needs of the customer. In other markets there are no 	

EIOPA INSURANCE AND REINSURANCE STAKEHOLDER GROUP – FEEDBACK

CONSULTATION ON DRAFT REPORT ON GOOD PRACTICES FOR DISCLOSURE AND SELLING OF VARIABLE ANNUITIES – JANUARY 2012

Comments Template on EIOPA-CP 11/007 Draft proposal for Report on Good Practices for Disclosure and Selling of Variable Annuities		Deadline 03.01.2012 12:00 CET
	such national information systems.	
Q2.	Consistency, simplicity, transparency and an aid to comparison. The aim must be to give clear information to help make more informed decisions about the purchasing of products that are suitable to specific needs and situations.	
Q3.	<p>The WS believes that VA product information should be clear, fair, not misleading and timely. As far as is reasonably possible, the product information should be provided in a format that facilitates comparison between providers and to the features of other, comparable, products. Key features should be consistent and customers should also be able to request more detailed information from potential providers. .</p> <p>While the precise form and content may vary according to the nature of the specific product, the WS is of the opinion that product information tools should be developed which include, where relevant, information on the following:</p> <ul style="list-style-type: none"> • Key product characteristics (that may vary according to product type), including the possible existence and features of any capital guarantee; • The nature of redress should things go wrong. Customers buying cross border need information about possible compensation and redress and the exact definition and nature of any guarantees, including who bears the risk • Investment risk and in particular the minimum agreed capital (which can vary in time) <ul style="list-style-type: none"> ○ Performance indicators; and ○ The precise nature of costs and the total amount of all costs (making clear the difference between the sum of all premiums paid and that part of the premium that is actually invested). <p>Upon request of the customer (where applicable via the intermediary), the provider of a variable annuity should at any time be prepared to give information on the performance of the product in particular if the benefits are not guaranteed. One WS member suggested this might be combined with special rights to cancel, although this might disadvantage the customer or lead to underperformance.</p>	

EIOPA INSURANCE AND REINSURANCE STAKEHOLDER GROUP – FEEDBACK

CONSULTATION ON DRAFT REPORT ON GOOD PRACTICES FOR DISCLOSURE AND SELLING OF VARIABLE ANNUITIES – JANUARY 2012

<p>Comments Template on EIOPA-CP 11/007</p> <p>Draft proposal for Report on</p> <p>Good Practices for Disclosure and Selling of Variable Annuities</p>		<p>Deadline</p> <p>03.01.2012</p> <p>12:00 CET</p>
	<p>Some WS members, while supportive of a high level of consumer protection for all consumers buying insurance products thought that, as insurance distribution markets vary significantly across Europe, a prescriptive regulatory approach may have negative implications both for markets and consumers. This is particularly so when it comes to the pre-contractual information that must be disclosed to consumers.</p> <p>The Role of Frequently Asked Questions</p> <p>While some members welcomed the use of information which might help customer understanding and help them relate scenarios and benefits to their own particular situation, the WS did query whether the number and nature of FAQs were excessive.</p> <p>Some particular comments from individuals are given below:</p> <ul style="list-style-type: none"> • FAQ can be a valuable tool, provided they are presented in a fair and simple way and highlight the disadvantages and potential risks of such a product as well as the advantages. • Care will have to be taken to ensure consumers, though, are not overwhelmed with material to such an extent that they do not read the key features document at all. • the provision of such a high amount of information would appear to go against the objective of streamlining pre-contractual information to allow consumers to make an informed choice. EIOPA should take account of the Report of the 3L3 Task Force on PRIPs, which stressed the importance of adhering to the principles of proportionality and materiality in developing product disclosure requirements, stating that disclosure should be a concise body of relevant and comparable information that can be understood by the investor and does not overwhelm or confuse the investor with too much information. • It would be preferable to stick to key features information as being defined for insurance products in general, 	

EIOPA INSURANCE AND REINSURANCE STAKEHOLDER GROUP – FEEDBACK

CONSULTATION ON DRAFT REPORT ON GOOD PRACTICES FOR DISCLOSURE AND SELLING OF VARIABLE ANNUITIES – JANUARY 2012

Comments Template on EIOPA-CP 11/007 Draft proposal for Report on Good Practices for Disclosure and Selling of Variable Annuities		Deadline 03.01.2012 12:00 CET
	<p>taking the significant differences between insurance markets in Europe adequately into account. Any doubling of requirements should be avoided.</p> <ul style="list-style-type: none"> The manufacturer can provide certain information, but the distributor should be obliged to inform the customer, based on the information provided by the insurer. <p>With reference to the ‘total amount of costs’, the manufacturer can include in the information inherent product costs, not distributor-incurred costs</p>	
Q4.	Some WS members believed information was required on a yearly basis at least by local regulations.	
Q6.	Downside risk should always be clear, so that consumers are informed about the risks as well as the benefits of such products. It is also important to clarify what the term ‘guarantee’ means, as often it is assumed by consumers that this will guarantee income and capital, yet often the term is used differently by the industry. We recommend that the term ‘guarantee’ is not used where the particular feature of the product is not in fact guaranteed in the way that consumers would understand it. If that cannot be done, it should be made absolutely clear that any limitation or contingency on what is being offered changes a guarantee into an aim or intention.	
Q9.10.	Insurance and financial intermediaries play an important role in the distribution of insurance and financial products and are the interface with consumers, guaranteeing clarity and comparability of increasingly diversified financial products. VAs are sold through a range of distribution channels. In some of the EU Member States, intermediaries are by far the main distribution channel for these products (although competition with other forms of distribution and direct distribution is strong).	
Q11.	<p>A pragmatic and practical approach could be to take the contents and parameters of a KIID of a product or a set of KIIDs as a source of inspiration for the basis for a dialogue between the consumer and the intermediary or provider.</p> <p>The KIID produced by the product manufacturer could have a general description of the possible target group. The specific information or the KIID information elements can be used as a checklist for testing in more detail the demands</p>	The CEA key information checklist (KIC) contains a general

EIOPA INSURANCE AND REINSURANCE STAKEHOLDER GROUP – FEEDBACK

CONSULTATION ON DRAFT REPORT ON GOOD PRACTICES FOR DISCLOSURE AND SELLING OF VARIABLE ANNUITIES – JANUARY 2012

Comments Template on EIOPA-CP 11/007 Draft proposal for Report on Good Practices for Disclosure and Selling of Variable Annuities		Deadline 03.01.2012 12:00 CET
	<p>and needs of the consumer.</p> <p>Information on the customer’s economic situation, purpose of the investment/protection, consumer knowledge of financial instruments, customer risk appetite, required time horizon are helpful.</p> <p>One WS member felt the KIID should be the responsibility of the distributor as the distributor owes a duty of care and pre and post contractual information. Practically, white label KIIDs will be provided to the distributor, similar to other marketing material.</p>	description of the investment objectives.
Q12.	<p>Some WS members thought that the nature of variable annuities is such that the products are not suitable for mass marketing. This is particularly important at a time when many consumers might be attracted to an investment that has some form of underlying guarantee of income. They argued that firms should take steps to ensure that the potential target market for variable annuities is identified carefully before the products are promoted and that important information around the identity of the underwriter and degree of downside risk are clearly articulated.</p> <p>Others disagreed. While agreeing target audiences needed to be defined, they felt mass marketing was appropriate and that the product was suitable and helpful for a broad audience and that they fulfil declared governments’ targets to cope with the consequences of demographic changes and the fostering of private old age provisioning. They can also prove attractive in providing flexibility in fluctuating income situations.</p> <p>One WS member felt mass marketing would not be harmful, provided it was combined with proper advice prior to signing off application forms.</p>	
Q14.	<p>This would entirely depend upon the situation and must be considered on a case by case basis. The same principles should apply to all distribution models.</p> <p>The main findings of the EIOPA draft Report are that good practices in relation to selling practices should ensure that variable annuities are always sold on an advised basis.</p> <p>As already articulated the WS had differing views, with some agreeing wholeheartedly with this view, (and arguing that</p>	

EIOPA INSURANCE AND REINSURANCE STAKEHOLDER GROUP – FEEDBACK

CONSULTATION ON DRAFT REPORT ON GOOD PRACTICES FOR DISCLOSURE AND SELLING OF VARIABLE ANNUITIES – JANUARY 2012

Comments Template on EIOPA-CP 11/007 Draft proposal for Report on Good Practices for Disclosure and Selling of Variable Annuities		Deadline 03.01.2012 12:00 CET
	<p>advisers also needed to be free of inappropriate incentives/remuneration practices, genuinely working in the client’s interest and demonstrating appropriate credentials and professional qualification/expertise) while others argued equally vociferously that variable annuities were suitable for mass marketing and did not require to be sold only on an advised basis, for all the reasons previously articulated.</p>	
Q15.	<p>Regarding due diligence on the intermediary, the starting point of any consideration in this respect is that intermediaries are regulated, registered and supervised (IMD) and that there are various models of intermediation.</p> <p>One WS member argued that this was not appropriate; product providers have increased responsibilities for intermediaries. The responsibility for intermediaries must always remain with the relevant supervisory authorities and with intermediaries themselves which is why they are obliged to have professional indemnity insurance. A requirement for product providers to assume greater responsibility for intermediaries will lead to the law of “unintended consequences applying”. Product providers may not wish to assume greater responsibility for large numbers of intermediaries and as a consequence, may decide to place greater emphasis on “tied intermediaries” and reduce the numbers of intermediaries that are not tied. This may adversely impact on consumer’s access to advice.)</p> <p>For advice to be of value, it must be provided by an individual with the necessary level of professional qualifications, independently assessed knowledge and expertise. Sales staff or advisers without expert knowledge of these products and the environmental issues that can have an impact on their performance would be unlikely to understand the product themselves and would not be in a position to provide the necessary information and advice to the client.</p> <p>Due diligence should also include continuing communication with the client beyond mandatory post sales disclosure information as an aid to root cause analysis in the event of significant levels of complaints cancellation or contract lapses.</p> <p>In terms of explaining the underlying mechanics of a variable annuity to the consumer, we do not think this is necessary. The key issue for the consumer is the risk arising from the structure of the product or the way in which it works, rather</p>	

EIOPA INSURANCE AND REINSURANCE STAKEHOLDER GROUP – FEEDBACK

CONSULTATION ON DRAFT REPORT ON GOOD PRACTICES FOR DISCLOSURE AND SELLING OF VARIABLE ANNUITIES – JANUARY 2012

Comments Template on EIOPA-CP 11/007		Deadline
Draft proposal for Report on		03.01.2012
Good Practices for Disclosure and Selling of Variable Annuities		12:00 CET
	<p>than detailed mechanics. Again the exact nature and definition of any ‘guarantee’ needs to be clearly explained, particularly as consumer understanding of guarantee is often very different to the industry’s understanding. A consumer view was that if the product could not offer a guarantee as understood by the consumer, that word should not be used as it was misleading for the customer.</p> <p>It was argued that Post-sales advice should be the clear task of the distributor and that e.g. for broker business the insurer might not even have client contact details.</p>	