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TRANSPARENCY OF SALES COMMISSIONS AND FEES IN INTERMEDIATION OF LIFE INSURANCE CONTRACTS

A mystery shopping internet-based survey on transparency of costs of insurance intermediation (banks, insurance companies, brokers) in 11 EU Member States

Summary and consumer policy demands

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Summary

The Federal Chamber of Labour carried out an online survey on the transparency of costs in life insurance offers in 11 EU Member States by using the method of mystery shopping. Two testers were involved in the survey: **Mystery Shopper 1**, aged 35, desired term of 30 years for insurance policies; **Mystery Shopper 2**, aged 49, desired term of 15 years for insurance policies. These two testers e-mailed inquiries to financial service providers (a total of 167 banks, insurance companies and brokers selected primarily by criterion largest market shares in consumer business; business premises contacted in at least two large cities per Member State) in 11 Member States requesting them to e-mail back a non-binding offer containing information about a. life insurance with the character of an investment and b. life insurance to cover the risk of death.

The **elements of the testers' inquiry** were:

- Request for offering a life insurance policy for saving and as a protection for wife in the event death of insured person.
- Affordable amount per month over desired term and requested guaranteed payout in the event of my death.

Important asked questions:

“Can you give me the benefit that will accrue at maturity, and the yield/interest rate earned on the policy?”

“Also can you tell me the administrative fees that will be charged on the policy, the commission charged if any, and any advisory fees or other costs?”

Data was collected in June and July 2013 (deadline for replies: mid-July 2013).

Main findings of the survey are:

1. High response rate in Mystery Shopping Survey

In the course of this Mystery Shopping Survey in 11 EU Member States (Germany, UK, Spain, Italy, France, Poland, Ireland, Finland, Slovenia, the Netherlands and Denmark)¹ a **total of 167 financial service providers** (banks, insurance companies and brokers) were contacted in the survey period of June and July 2013 regarding two different consumer profiles:

- 114 in the course of Mystery Shopping 1 and
- 53 in the course of Mystery Shopping 2.

¹ The survey concentrated on the most populous countries namely, Germany, Great Britain, France, Italy, Spain and Poland.

The response rate for Mystery Shopping 1 (tester 1, 35 years old, 30 year term for desired life insurance policies) was a respectable **62 per cent** and for Mystery Shopping 2 (tester 2, 49 years old, 15 year term for desired life insurance policies) was **51 per cent**.

The **response rate** varied greatly from one country to the next. Financial service providers from Germany displayed a great willingness to respond whereas those from Italy had the lowest relative response rate. From the (general) response rate, **a total of 27 financial service providers** (banks, insurance companies and brokers) sent insurance offers (offer with data on life insurance with the character of an investment and/or on life insurance to cover risk of death):

- **15 financial service providers** from the Mystery Shopping 1 survey. This means about 13 % of the financial service providers contacted also sent data in their insurance offers (as a percentage of the 114 inquiries sent).
- **12 financial service providers** from Mystery Shopping 2 survey. This means about 23 % of the financial service providers contacted also sent data in their insurance offers (as a percentage of the 53 inquiries sent).

2. Quick response times but many indications that a personal consultation session was needed (no data sent along with the offer)

Many financial service providers responded within 24 hours, which was considered a quick response to customer concerns. Equally notable, however, were the reasons cited as to why no offer or the desired product information could not be sent by e-mail. The most frequent one named was the need for a personal consultation session. In these cases, the consumers were instructed to contact the nearest branch or take advantage of a phone consultation, particularly by financial service providers from Great Britain and Italy. A striking observation for English banks and insurance companies was that opening an account or buying a life insurance policy was contingent on a number of conditions (stay in UK, etc.). In summary, one can assume that **entering into cross-border insurance contracts in distance selling** poses a number of difficulties (reasons: minimum stay or residence in the Member State required, personal consultation session absolutely mandatory, etc.).

3. Product information sheets in Germany: high information standard for information on acquisition costs (commissions)

The written offers on life insurance policies differed considerably as regards information standards. There were extremely detailed offers with information packages that included model calculation, product information sheet and enclosed insurance conditions (clauses). Even applications were enclosed. In many cases, only a few items of data about the offer were outlined in the e-mail and there was no understandable information on rates beyond that. A comparison is made all the more difficult by the **different information standards** but also the **different** product concepts for life insurance policies

which are country-specific in some cases. In addition, there are **no (standardised) key figures** for capital-accruing life insurance to express the (guaranteed, estimated) return. The **German financial service providers** (banks, insurance companies and brokers) provided the most **data in their offers** with some providing extensive cost information (acquisition costs where intermediary was involved, administrative costs for insurance company, other costs and taxes). The product information sheet, which is mandatory in Germany, was very often attached to the e-mails from the providers and above all, listed the acquisition costs, usually on page 2. In all product information sheets from German financial service providers, the acquisition costs (commissions) were broken down as a euro amount whereas **not** all product information sheets contained the acquisition costs expressed as a percentage of the (agreed) total premium amount.

It should be emphasised that several offers from Germany attempted to present the total costs in the form of a total cost ratio.

4. Bandwidths of named commission rates for life insurance policies

Mystery Shopping 1: Some of the 15 financial service providers (banks, insurance companies and brokers) who supplied insurance information indicated the commissions (in relation to the premiums paid) with the following bandwidths:

- Capital-accruing life insurance: 3.7 % - 4.02 %
- Strict risk insurance: 2.75 % - 3.85 %.

Mystery Shopping 2: Some of the 12 financial service providers (banks, insurance companies and brokers) who supplied insurance information indicated the commissions (in relation to the premiums paid) as follows:

- Capital-accruing life insurance: (1 % on premium)² / 3.17 % - 3.98 %
- Strict risk insurance: 3.7 % - 6.23 %

5. Sparse information on professional fees

The information on professional fees was quite sparse. For one thing, several inquiries about costs, acquisition costs and professional fees were usually required before one received information on the insurance intermediaries' compensation. The (first) e-mail inquiry contained an explicit question about the policy acquisition costs and the basis of compensation.

A **Polish insurance broker** indicated that he would charge a flat fee of EUR 500 to find, select and take care of contractual arrangements for a life insurance policy.

A **Dutch broker** said he would charge a professional fee based on type of contract (risk insurance, life insurance with the character of an investment), his rate for risk insurance being EUR 340 and for classic life insurance being between EUR 340 and EUR 765

² Indicated in one Spanish offer whereby it was unclear to whom this expense rate was due (intermediary or insurance company)

depending on the hours of work involved (4 to 9 hours). Thus, his hourly rate was EUR 85.

Just one of the four German insurance brokers who responded to Mystery Shopper 2 indicated he would work on a fee basis; which of the two—professional fee or commission—is more advantageous for customers has to be decided case by case. Three German insurance brokers indicated they worked solely on a commission basis. The reason they named was that only a handful of insurance companies offered rates free of commissions. The brokers working on a fee basis was not prepared to indicate his hourly rate or professional fee rate.

Two English insurance companies (Mystery Shopping 2) said “*There is no advising fee*” and “*It is a free service we provide.*” The only proviso is that the companies’ advising units be used (telephone-based service).

One **German bank in Munich** responded as follows to the question the test shopper asked about its employees’ compensation: “*Our employees do not have commission and performance-based contracts.*”

6. Poor transparency regarding compensation in general

The transparency regarding compensation for arranging insurance policies is generally quite poor. Insurance intermediaries (especially brokers) in all 11 Member States covered in the study were sluggish about answering questions regarding compensation as asked in the Mystery Shopping inquiries and some did not answer them at all. Most insurance brokers who did give answers about compensation did so only after being asked multiple times. Moreover, the information about compensation was quite general as a rule, for instance: “*We receive a broker’s commission from the companies.*”

The answers regarding compensation were not only extremely vague but also misleading and not very correct. **Examples:**

- One German insurance broker wrote: “***Our service does not cost one cent; we receive a broker’s commission from the companies.***”
- A French insurance broker had this to say: “***Our advice is free of charge. There is no fee rate and we do not charge a fee.***”
- Another insurance broker had this to say about compensation: “No fee is charged; the documents are examined free of charge (at the company’s expense).”

This view passed on to customers is not correct because the insured has to pay the concealed commission on signing the contract. In addition, claims such as “free of charge” or “free” promote a “free-of-charge mentality” and prevent consumers from becoming cost conscious.

The written information the insurance brokers sometimes use as attachments in their e-mails to explain their profession contain almost no concrete information about the compensation received by an insurance intermediary. Instead, advertising claims such as the following predominate: “*We are offering you the best value for a wider range of benefits for your insurance in France.*” (taken from the **e-mail of a French broker**).

One exception was the information provided by a **German insurance broker**, who divulged the following of his own volition in an attachment called “Important Customer Information”: “The insurer pays the usual broker’s fee for intermediary services surrounding the insurance contracts.” Although far from concrete, this phrase was at least contained as a standard statement in the written materials the test shopper received (unsolicited).

7. Cost information difficult to understand

In several cases it was unclear how to interpret the cost information.

Examples: In an offer for **Spanish life insurance** (offer from a Spanish broker), the formulation under the section “*Gastos*” (translation: costs) read as follows: “*1% sobre prima*” (1% on the premium). This 1% surcharge on the premium raises the question (for an inexperienced insured party) as to the cost item for which the percentage named is incurred and who is due this fee rate.

In many cost items in **Italian insurance offers** it is also difficult to identify the recipient (clearly). Is it the intermediary? The insurance company? A government authority?

The information in the offers from a **French broker** raise the question as to whether the phrase “*2% par votre conseiller*” means that the broker receives 2% of the money paid in by the insurance customers as compensation.

This same question arose **in connection with another French broker** whose attached insurance offers contained the following – quite inconspicuous – formulation: “*Des frays d’entrée de 5% sont prélevés sur les sommes versées.*” (i.e., “Five per cent of payments is charged as entry fees.”) From this statement it was unclear who received these entry fees deducted from the payments. The consumer can only assume that a portion of this percentage is paid to the intermediary. But no explicit indication was made as to whom these costs are due.

BAK consumer policy demands

As the survey shows, in most countries, intermediaries do not disclose the form and level of remuneration they receive. **Receiving clear information on costs is unfortunately the exception.** Consumers are not enabled to compare offers and this is an obstacle for distance selling transactions. Therefore BAK demands a mandatory standardised product information sheet to be introduced for life insurance contracts (investing) to increase cost transparency (in particular of costs of intermediation).

Moreover, BAK suggests introducing a mandatory standardised product information sheet for all insurance parties to increase the general transparency of insurance products.

BAK suggests **no more up-front loading**; instead all commissions have to be distributed **over the whole lifetime** of the contract. By this, intermediary’s interest will be incentivised

to conclude contracts which are fulfilled by consumer until maturity (and which are not terminated before maturity).

For endowment life insurance policies, BAK demands that an effective annual interest rate (effective guaranteed interest rate) be required to be indicated in the calculations in the offer (offers) and in insurance policies to depict the net profit and to take reasonable account of the substantial costs of a life insurance policy (particularly closing costs, administrative costs, risk premium).