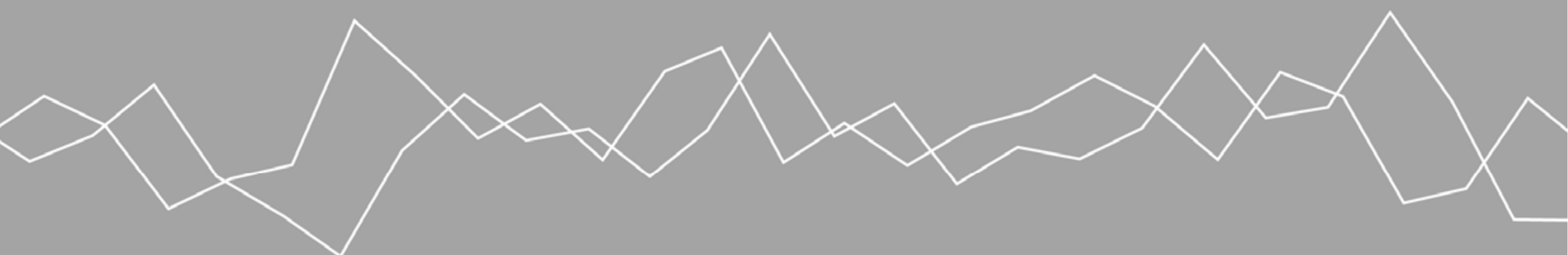
Evaluation of commission rules for complex products



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Evaluation of commission rules for complex products

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Table of contents

Preface i

Conclusions iii

In summary v

1 The question under investigation 1

1.1 Context 1

1.2 Research method 2

2 Framework of analysis 5

2.1 Information asymmetry 5

2.2 Adverse selection 7

2.3 Towards a healthy market 8

2.4 The commission rules 9

2.5 From theory to practice 11

2.6 Scope of the research 13

3 Market outline of advisers and intermediaries 17

4 Findings 19

4.1 Internalisation of the regulations 19

4.2 Familiarity with the regulations 21

4.3 Interpretation of remuneration transparency 24

4.4 Balancing rule 31

4.5 Inducement 34

4.6 Evasive behaviour 43

5 Consequences for the market 45

5.1 Intermediaries' business practice 45

5.2 Level playing field distribution channels 46

5.3 Level playing field within the intermediary channel 46

Appendix A Questionnaire in detail 49

Appendix B Accountability and sources 51

Preface

Advising on complex financial products and the sale of such products are both services to have been placed under a more stringent legislative regime over the past five years, a regime that includes supervision.[1] The *Financial Supervision Act* (Wft) and the *Decree on Supervision of Financial Enterprises under the Wft* (Bgfo) are the most important expressions of this. It is the Netherlands Authority for the Financial Markets (AFM) that carries out this supervision. The regulations are based chiefly on the premise that consumers have little insight into such products, that they cannot properly assess whether the suppliers concerned (offering parties and intermediaries) are making sufficient efforts on their behalf and thus that they require protection.

In December 2009, the Minister of Finance gave an undertaking to the Netherlands House of Representatives that the effect of the amended policy on commissions would be evaluated in 2010. Following from this, the Ministry of Finance asked SEO Economic Research to conduct a research assignment, the key questions therein being whether *"the policy amendments in relation to commission regulations, specifically in the areas of remuneration transparency, the balancing and commission refunding rules, and inducement standard, have their intended effect on the conduct of banks, insurers, advisers/intermediaries and consumers?"* and whether *"there is already a perceptible change in the market from product-focussed selling to customer-focussed advice and, if so, the phase that this transition had reached?"* This report gives our findings. In line with the research assignment, the report takes a retrospective approach; the formulation of these questions relates strictly to how developments in the recent past have made headway vis-à-vis the situation in 2010, and it abstracts from policy recommendations. The policy makers now have the floor.

It was clear on commencing the project that unequivocal answers to many of the formulated constituent questions did not or could not (yet) exist. It is the case that the regulations are recent in date, while many other factors are at play in the markets concerned and 'the great market information system' is simply non-existent at present. Therefore, the research process focussed on collecting together partial information from all manner of sources, weighing these pieces of information against each other: research reports, existing databases, surveys conducted especially for this study through TNS Nipo, and facts and opinions gathered from interviewees in and adjacent to the market. This kaleidoscope of information has been brought together in the report. We would like to thank all the contributors. The interviewees can be reviewed in Appendix B to this report. We would like to give special thanks to the Stichting Financiële Dienstverlening (StFD) whose anonymized databases provided a good picture of the state of compliance in respect of intermediaries in the Netherlands. Nor should we neglect to mention the contributions made by respondents to the various surveys. The ministry's administrative team also deserves a special note of appreciation. They supervised our research in a professional and encouraging manner, maintaining a well-balanced combination of commitment and detachment.

September 2010, *Barbara Baarsma*, SEO Economic Research managing director
Peter Risseeuw, project manager

[1] By and large, complex financial products correspond to mortgage loans and life insurance policies that are connected to investment products with an uncertain return.

Conclusions

Are customers informed about the services that they might expect and about the cost of those services?

Strictly speaking, this is the case. The market players largely adhere to the rules on transparency regarding costs and services. However, this is not always done with the greatest of conviction. A culture has arisen in the market that is focussed on meeting the requirements formulated by the supervisor in order to avoid sanctions and to exclude liabilities. This is rather different from the shift in culture and conduct as envisioned by the legislature and supervisor. Consequently, informing customers intentionally and willingly for the purpose of rendering services and prices transparent is only limited in its extent. The objective of informing potential customers 'on the threshold' about what they might expect in terms of services and costs is not being realised. However, a slowly growing awareness is emerging in the market concerning the role and accompanying financial flows of the various players in the distribution chain. Customers still have qualms about the feeling that advice is not for free.

Does this transparency result in consumers who are more informed and critical?

To an extremely limited degree. Obtaining information is one step; converting that information into understanding and action, which is what transparency ultimately involves, is another. A vast majority of consumers view the services statement and statement of costs as documents that belong by and large on top of an already steep pile of documents pertaining to financial products which lack easy accessibility and which they would rather push to one side. Those consumers who familiarise themselves with the information concerned do feel properly informed. However, that has a limited effect on their decision-making behaviour. There is hardly any question of consumers being more active in familiarising themselves with brokers and products, which is an essential precondition for being able to establish a negotiating position on the basis of awareness.

Have the perverse remuneration incentives disappeared from the market?

The most important of these perverse incentives, the turnover-related bonus, has been removed from the system thanks to the inducement standard. The practice of 'hit-and-run' consulting has been largely banished, partly due to the balancing rule, partly due to the wider-ranging requirements imposed on intermediaries and advisers by the Wft, and in part due to the fact that the market for equity-linked policies has virtually dried up following all the news reports of extortionate policies. However, this is not to say that all of these perverse incentives have gone. For example, there is still the matter of turnover quotas (minimum output requirements).

Have substitute remuneration incentives appeared with comparable undesirable effects?

It appears evasive behaviour takes place, although it is hard to prove. It materialises, for example, in the transfer of fees to sectors that fall outside of the commission regime (the 'water-bed effect') or through charging large sums (in the words of the AFM, 'excessive fees') in such a way

that it falls outside of the commission regime. The extent of this behaviour is difficult to ascertain. Market players observe that this will happen as long as these mechanisms continue to exist.

Is the quality of advice improving?

The removal of perverse incentives is not enough in itself. As long as consumers either do not wish or are unable to take an informed and critical stance due to their lack of interest and/or information, the market players will have the opportunity of keeping costs and fees artificially high. Critical mass is necessary in order to remove perverse remuneration incentives entirely: that is to say, a sufficiently large group of consumers who start to 'shop around'. It is crucial to this that the regulations launch their primary strike at making prices transparent. Quality has not been made manifest even with the new regulations. For as long as quality remains invisible, and delivering additional quality does cost advisers money, the danger exists of an increasing uniformity in terms of supply: too little diversity means too little choice. Shopping around is pointless for consumers in a market where there is no choice, and neither can they get transparency with regard to value for money.

Nevertheless, there is a general belief among market players and those involved around its fringes that the quality of consulting and the suitability of the products sold have improved since the coming into force of the supervisory regime. It should be noted further to this that two other major developments in the world at large (the internet and the recession) have also placed these players under pressure, thereby encouraging them to go just that little bit further for their customers. Customers themselves – about whom all of this is concerned in the end – are still far from being in a position to form a judgment about the quality of the services offered to them. It is not possible to underpin the conclusions about quality improvements using consumer data.

Is there evidence of an expansion of supply? Does the customer get greater freedom of choice?

Great uniformity continues to exist in the way in which advisers perform their work and in the way in which they are paid for it. A shift towards forms of remuneration other than commissions is slowly taking hold, although in the case of mortgage broking there is in fact a development in the direction of direct payment for consultations. The number of insurance companies in the market whose products intermediaries are carrying in their range is getting smaller.

Owing to the fact that players are interpreting the regulations' open standards in a highly similar manner, the market is heading towards the middle ground. Taken in conjunction with imperfectly informed consumers (disregarding the issue of whether that is due to the suppliers or the customers themselves), this threatens to result in a process of 'adverse selection' whereby it is precisely those advisers who focus on delivering high quality who are in danger of disappearing from the market. This leads to decreasing supply, quality levels go into decline and freedom of choice being restricted instead of being expanded.

In summary

The regulations have contributed to a process in which the interests of the customer are better safeguarded. However, advancing technological developments (the internet) and the economic crisis are also making their own contribution to that process. Some abuses have disappeared. Above all, this progress is also linked to the fact that market players are keeping technically to the rules imposed on them.

The desired cultural shift in which customer focus was to take centre stage as a matter of course is not in evidence at the moment. It is a warning that the rearrangement processes at work in the market relate chiefly to the relationship between insurers and intermediaries and not to the position of customers. They themselves also have little interest in obtaining a serious place in the distribution chain, and they are not encouraged to do so by the market players.

1 The question under investigation

"…because a considerable amount has indeed been achieved. Nevertheless, all of the market players must remain alert to the fact that the world is now by no means free of everything that caused us problems in terms of improper products and improper practices. Neither have all of the people who practiced in a less than blameless manner in the financial market now disappeared, nor have they been set on the right path through tuition, for example."
J.W. Wabeke, Financial Services Ombudsman,
2009 Annual Report of the Financial Services Complaints Body (KiFiD)

1.1 Context

Set against the background of technological change (the internet), an economic crisis (a slumping housing market), extortionate policy scandals and an evolving supervisory regime, a debate is underway in society concerning financial products, the way in which they are sold and the way in which the parties involved are paid for them. The debate is still ongoing among the market players (insurers, banks, consultancies and intermediaries) and in politics (the House of Representatives). The major absentee in the debate is in fact the consumer. This is of some note given the fact that the legislation and regulations concerning the distribution of financial products have in large part been imbued with the concept of consumer protection.

A significant component of the legislation and regulations is a framework regarding the remuneration of the intermediaries who sell and the advisers who offer advice on complex financial products. The *Financial Services Act* (Wfd), introduced in 2006 and as of 1 January 2007 absorbed within the *Financial Supervision Act* (Wft), and the accompanying *Decree on Supervision of Financial Enterprises under the Wft* (Bgfo) included rules in respect of (1) the transparency of remunerations, (2) the appropriateness of the remuneration ('inducement standard') and (3) harmonising the efforts of the intermediary with the remuneration that the intermediary receives ('the balancing and commission refunding rule'). These commission and transparency rules put an end to an almost matter-of-course and permanent flow of income from insurers towards intermediaries. Volume based bonus commissions are no longer allowed. It should be added to this that the commissions which continue to be permitted are to be paid in a more spread out fashion over time. Moreover, the risk is increasing that commissions will have to be paid back if current policies are cancelled in the interim within ten years.

The rules aim to strengthen the position of the consumer in the insurance and mortgage markets. Consumers are not well equipped to scan the properties of complex financial products and, therefore, require professional and objective advice, whereby their own interests are put first. By better informing consumers about the product and about the services and attached fees of the parties involved, they are theoretically better placed to make decisions when choosing advisers, intermediaries, providers and financial products. By removing financial incentives that might di-

rect an adviser or intermediary to a less than optimum product or a less than optimum provider, the likelihood of mis-selling is reduced.

1.2 Research method

On 3 December 2009, the Minister of Finance the Minister of Finance gave an undertaking to the Netherlands House of Representatives that the effect of the amended policy on commissions would be evaluated in 2010. This undertaking is reflected in the questions under investigation:

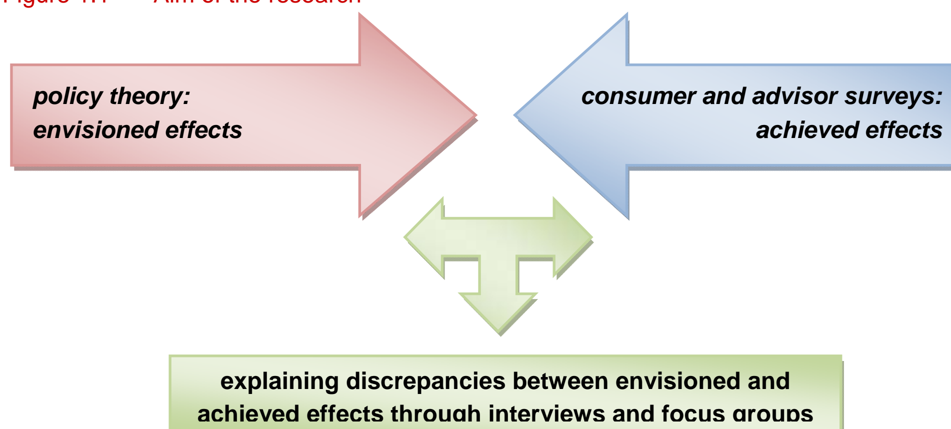
> *"Do the policy amendments in relation to commission regulations, specifically in the areas of remuneration transparency, the balancing and commission refunding rules, and inducement standard, have their intended effect on the conduct of banks, insurers, advisers/intermediaries and consumers?"*

and

> *"Is there already a perceptible change in the market from product-focussed selling to customer-focussed advice and, if so, which phase has this transition reached?"*

The evaluation involves placing side-by-side the envisioned and realised effects of the commission rules. Figure 1.1 illustrates the aim of the research in diagram form. To enable an assessment of whether these behavioural effects correspond to the behavioural effects as intended and envisioned by the commission rules, the key questions under investigation as shown above have been expanded into a large number of more detailed questions. These have been included in Appendix A.

Figure 1.1 Aim of the research



Source: SEO Economic Research

The evaluation is a matter of ascertaining whether instruments concerned result in behavioural changes among the market players (advisers/intermediaries and providers) and whether the interests of the consumer are actually being better served because of this. Behavioural changes in consumers and advisers/intermediaries that have actually been achieved are gauged insofar as is pos-

sible. We say 'insofar as is possible' because the questions under investigation do not always lend themselves to a quantitative approach. For example, the question of whether there is less evidence of mis-selling implies insight into how the degree of mis-selling has developed. Further to this, there is the matter of causality: if a behavioural change is indeed in evidence, is that change then the direct or indirect result of the regulations or has it been dictated by the recession, by technological developments or by other developments in the market? Even though not all of the questions can be answered in quantitative terms, it is best to render as representative an overview as possible. For that reason a mixed qualitative/quantitative approach has been decided on as the research methodology.

Research among consumers

A survey was conducted especially for this report from among 1,062 consumer households (taken from the TNS Nipo consumer panel) that had recently acquired or made inquiries about a complex financial product. The consumers were asked about how they had been informed by the intermediaries and/or providers and about the degree to which the information had affected their decision-making process.

Research among intermediaries

TNS Nipo sent out a survey especially for this report to the management at firms of intermediaries and advisers licensed for life insurance and/or mortgage broking. The invitation was accompanied by an appeal from the Minister of Finance to participate in the study. 1,308 firms responded positively to that appeal. The intermediaries were asked about their familiarity with the existing legislation, about the way in which they interpreted transparency of services and fees, and about the consequences that the various aspects of the regulations have had on business practice and relations with their customers.

Interviews

As a supplement to the source research and the various databases, a series of interviews were held with stakeholders and other professionals always from the point of view of the regulations: to what degree had the regulations led to change, had this improved things for the consumer, and could such insights be substantiated in any way by facts and/or figures?

Appendix B provides further information on the research modules and other sources of information used.

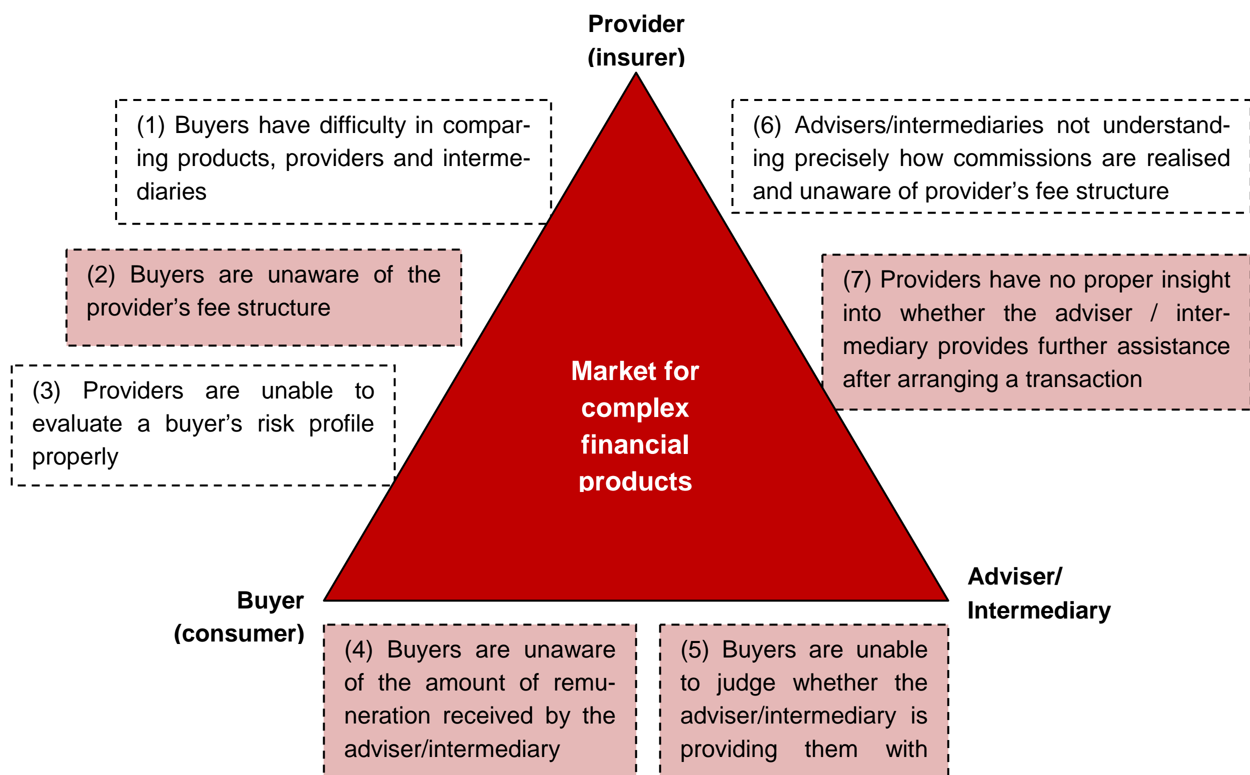
2 Framework

Information asymmetry and adverse selection are important interrelated mechanisms in the financial products market. The regulations are imbued with preventing mis-selling. This chapter puts all of this into context.

2.1 Information asymmetry

The prevention of mis-selling (the sale to consumers of financial products that are incompatible with their financial situation or risk profile) is one of the chief considerations in the regulations on commissions. The concept of information asymmetry has a key role to play in this. Therefore, when considering the effects of the commission regulations, it is important to understand which (information-related) problems arise in the market for complex financial products. The various types of information asymmetry are illustrated in Figure 1.2.

Figure 1.2 Types of information asymmetry in the insurance market with intermediaries (shaded information problems are being addressed by the commission rules)



Source: SEO Economic Research

Information asymmetry entails a market player in a financial transaction having less information than the market player with whom he is doing business concerning either the market player himself or the product or service that is being supplied.[2] Partly as a result of this inequality, both pro-

[2] The relationship between the consumer and an independent adviser/intermediary can be viewed as a principal-agent relationship: the consumer authorises the adviser/intermediary to represent his interests,

viders (especially insurers) and consumers have to incur transaction costs. Part of these costs can be reduced through the intervention of an adviser/intermediary. The latter can reduce the information asymmetry between consumers and providers in the distribution chain for complex products. This relates to information problems (1)[3] and (3)[4] as shown in Figure 1.2.

Research shows that advisers/intermediaries often do not know precisely how their commission-based turnover is composed.[5] The consequence of this is that the advisers/intermediaries look upon the commission received across their whole portfolio as an aggregate unit. As a result, they do not focus on the individual consumer but on their total portfolio. The commission rules do not have any direct effect on information problem (6). This information problem is less of an issue if the adviser/intermediary's fee is related to his efforts, e.g. in the form of a statement based on hours worked.

Apart from the composition of their turnover, advisers/intermediaries are also unaware of the provider's cost structure. This makes it more difficult to negotiate a purchase price and to apply a net pricing model. The new commission rules make no provision for this.

The intention is for the commission rules to minimise part of the remaining information problems:

- Information problem (2): the costs that an insurer is charging for a supplied product are unclear to consumers. Consumers are aware only of the total contract sum and are not aware of the premiums to be paid on the one hand and the cover and returns on the other.
- Information problem (4): the average consumer has a poor understanding of the level and structure of remunerations for advisers/intermediaries. This can have two consequences. On the one hand, remuneration for the adviser/intermediary can be high without the consumer being any the wiser. On the other hand, differences in remuneration may exist between different insurers with the result that the adviser/intermediary might lack the incentive to advise the consumer about a suitable product.[6]
- Information problem (5): given that this involves complex products, it is difficult for the consumer to be able to assess whether or not the intermediary is recommending a product that is suitable for him. Thus the consumer is unable to be a good judge of the quality of such advice.
- Information problem (7): providers do not have proper insight into whether the adviser/intermediary provides further assistance after arranging a transaction.

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but is unable to judge whether that adviser/intermediary is doing this properly. Information asymmetry is a significant cause of this. Incentives to guarantee that the agent represents the principal's best interests lie at the heart of *agency theory*.

3 Buyers can find it efficient to engage an adviser/intermediary for advice when the matter is one of a product with a low level of uptake, existing in a volatile environment and subject to a high degree of complexity. Although the information asymmetry is dictated in part by the nature of the complex products, it is reinforced by a low level of consumer involvement.

4 This is an expression of the *adverse selection* problem: those wishing to be insured are precisely those people with high-risk profiles, while suppliers are unable to distinguish between good risks and bad ones. A supplier can implement *screening* in order to get a better evaluation of buyers' risk profiles. Since intermediaries are often better informed about buyers' personal situations and requirements, they are as a rule in a better position to conduct such screenings and thereby reduce the costs.

5 This is shown, for example, from interactions with those taking part in benchmark studies among insurance brokers, such as those carried out in the recent past by SEO.

6 *Best advice* does not form any part of the regulations. Pursuant to the Wft, an adviser should advise the customer about a *suitable product*.

2.2 Adverse selection

Informing consumers on its own will not remove the consequences of information asymmetry. Research shows that customers in the financial sector have little interest in the costs of the advisory and intermediary process. The extent to which the costs that they pay are divided among the costs for advice, intermediaries' commissions and the provider's administrative costs, does not matter to the majority of customers.[7] They regard the chain of providers and intermediaries as a single system, in which it is the job of the intermediary to organise the maximum mortgage. They assess the attractiveness of a product in terms of its total cost and are more likely to view greater insight into the costs of the various components as complicating matters rather than clarifying them.

Not all customers are the same in that regard. In 2004, the AFM conducted research in collaboration with TNS Nipo into the way in which consumers made financial decisions.[8] This produced a typology of four groups: *those in control, the ambitious, the advice-sensitive* and *the convenience seekers*. Those designated as in control constituted the exception in this foursome: they want to be able to make their own considered decisions and, therefore, are open to relevant information. This group will appreciate transparency and will put it through its paces. The other groups are expected to accept such information chiefly for notification purposes and to let it influence their behaviour much less.

At the time of taking out a financial product with a long lifespan, consumers are inherently or virtually in no position to assess the value of the intermediary's contribution. After all, part of that value can be shown only following the passage of time, in the event of changes to personal circumstances or to the conditions, which can result in a policy's renewal on different conditions, its premature termination or its transfer to another insurer. Thus it is not simply a matter of a lack of interest on the part of the consumer, but also of a feeling (conscious or otherwise) that the information concerning costs and services does not have a high a priori value. One of the ideas underpinning the advance transparency of services and remuneration is to encourage customers to cast their net more widely (i.e. to shop around) and, in so doing, to develop a sense of the value that the various players in the process can generate for them. This shopping around does not come for free: it takes time and effort. Consumers have to be prepared to invest in information and greater comprehension.

If consumers cannot or do not wish to assess the added value of a properly trained intermediary who has integrity – and this is why intermediaries are able to distinguish themselves only on the basis of differences in price and not in terms of quality – an incentive for intermediaries to deliver high-quality services goes missing. This gives rise to a process of *adverse selection* (Akerlof, 1970).[9] Since intermediaries are unable to distinguish themselves on quality grounds, the market price inclines towards the price appropriate to an average level of quality. Intermediaries offering an intrinsically higher level of quality, which in general comes with higher costs, become loss-makers and will disappear from the market as a consequence. Average quality declines as a result,

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[7] Association of British Insurers (2009), *Adviser charging in the Protection Market – Strictly Financial*, ABI Research Paper.

[8] The Netherlands Authority for the Financial Markets (2004), *Kennismaking met de financiële consument [Getting to know the financial consumer]*, Amsterdam: AFM.

[9] Akerlof, G.A. (1970) "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism", *Quarterly Journal of Economics* 84(3): 488-500.

causing the market price to drop still further, and so on. In an unregulated or poorly regulated market, this process would result in intermediaries who are less professional and who have less integrity being left behind, while their professional and honest colleagues are driven from the market. The danger then arises of too little diversity and freedom of choice, as well as of prices that are too high in relation to the quality delivered; the fact is that quality is not a visible quantity, and the buyer cannot make a choice based on the best price/quality ratio. Where adverse selection arises, it is a significant indication of the existence of (continual) information asymmetry.

2.3 Towards a healthy market

The regulations up for discussion in this report concern transparency and remuneration rules. These two factors are connected. To be able to exert an influence on (for which read 'being able to counterbalance') his adviser, the customer needs to be well informed about *what* the adviser does for him (i.e. the services have to be well described), *how* the adviser does this (the quality has to be described) and *what it costs* (the price must be clear). The better informed the customer, the less opportunity there is for advisers to place their own interests above those of the customer, and the intermediary is thus more of an advocate for the customer. The ideal world in which the customer is able to assess and select his advisers on the basis of full information does not exist. Decisions are made within the context of *bounded rationality*: information is always limited, and the framework for evaluation is always incomplete.[10]

This notwithstanding, a high degree of transparency is feasible with regard to costs and services. It is possible to be entirely clear about the price that the customer will pay both now and in the future for the financial product and for the services from the players concerned. Transparency in terms of quality is inherently limited. With transparent services and a properly functioning mechanism for reputations serving as a foundation, customers are able to form an idea of how significant an intermediary might be in terms of services and of the professionalism and integrity with which those services are delivered. Since (complex) financial products are generally taken out for a long period, it is by definition uncertain how the quality of the service provider will develop and whether the service provider will react effectively to changes that might arise in respect of the customer's personal situation.

The more ill informed the consumer, the less influence (*empowerment*) he will have on his suppliers and the greater the danger is that providers and intermediaries will put their own interests first and saddle the customer with unsuitable products. The existence of remunerative systems that contain perverse components (such as volume bonuses) increases the likelihood that the customer will be burdened with inappropriate products at too high a price. The better informed the customer – and the more prepared the customer is to actually use that information – the less opportunity there will be for perverse remunerations to take root in the market. The fact is that the customer can provide a counterbalance. Table 2.1 shows the connection between transparency and remuneration in terms of the danger of mis-selling, adverse selection and freedom of choice, which translates into the breadth of an offer.

[10] H.A. Simon (1947) *Administrative Behavior*, New York: Macmillan.

Table 2.1 The connection between information asymmetry and remunerative incentives

	position consumer			danger of players chiefly serving own interests		danger of dverse selection	danger of increased uniformity in what is on offer
	is informed about		can provide counterbalance	perverse remunerative inventives exist			
	price	**quality**		**yes**	**no**		
benchmark situation	no	partly	no	very great	great	yes	very great
price transparency only	yes	no	inadequately	great	present	yes	great
insight into quality only	no	partly	barely	great	present	limited	minor
second best (realistic goal scenario)	yes	partly	reasonably	present	minor	no	very minor
ideal (unfeasible)	yes	fully	fully	n/a	nil	no	nil

Source: SEO Economic Research

The market is emerging from a situation where consumer information has been in considerable arrears and where there has existed a practice of perverse incentives in the shape of bonuses and other driving mechanisms aimed at tying intermediaries to providers, i.e. the benchmark situation in Table 2.1. While it is not a hard and fast rule that consumers will come off badly in such a situation, the likelihood of aberrations is still high.

The objective of the regulations is for the market to move in the direction of an ideal – or, considering that information-in-full does not exist, a 'second-best' world – in which the consumer is well informed and prepared to work with that information and in which there is no remunerations system in operation to tempt providers and intermediaries to supply products and services chiefly to serve their own interests.

Ultimately, the regulations ought to result in a market where the players conduct business based on good business acumen and in which the interests of the customer are where they should be: in first place. If the players (including consumers themselves) were to internalise that body of thought, one would be able to speak of a cultural shift, which is the goal implicitly envisioned by the regulations. The practical evaluation questions as elaborated in paragraph 4.1 are aimed at indicating whether and to what extent the sector is moving from the benchmark situation to the second-best world.

2.4 The commission rules

The commission regulations have been laid down in the *Financial Supervision Act* (Wft) and in the *Decree on Supervision of Financial Enterprises under the Wft* (Bgfo). Since the Wft has been largely worded in the form of 'open standards', supervisory policy on the part of the AFM is important for the creation of legal precedents. The AFM issues guidelines, which the market interprets as setting standards.[11] The commission rules focus not only on complex financial products (see Box 2.1) and mortgage loans, but also on unemployment payment-protection policies and funeral insurance policies.

[11] AFM, *Leidraad passende provisie [Guidelines for appropriate commissions]*, Amsterdam, August 2009.

Box 2.1 Complex financial products

Article 1 of the Decree on Supervision of Financial Enterprises under the Wft (Bgfo) mentions a number of products specifically as being complex. These are as follows:

- a combination of financial products, at least one of which depends on developments in the (financial) markets;
- the right to a participating interest in an investment company, not being securities;
- a life insurance policy, with the exception of (benefits-in-kind) funeral insurance policies and term life insurance;
- combined mortgages (savings-linked and endowment mortgages; a mortgage combined with a life insurance policy or a savings account);
- an investment property;
- a combination of the above with at least one other financial product.

The interpretation of the policy on commissions covers three main points:

- *Remuneration transparency*: in the pre-contractual phase, customers have the right to be informed about the way the adviser/intermediary is paid for the advice given on and/or for the sale of a financial product, as well as the amount of such remuneration (Article 58, paragraph 1, Bgfo).[12] Insurers advising and selling directly to consumers must indicate their distribution costs and the nature and scope of their services (Article 58, paragraph 3, Bgfo).[13] An important accompanying instrument is the services statement, which the adviser/intermediary should hand over to the customer at an early stage during the proceedings. This document sets out the services that are available and how the adviser/intermediary is paid for providing such services (Article 149b, Bgfo).[14]

- *Balancing and commission refunding rules*: to prevent the practice of 'hit-and-run' advice, a reduction has been made to the proportion of an adviser or intermediary's remuneration that may be composed of brokerage commission. The *balancing rule* determines that the brokerage commission to be paid by a provider to the adviser/intermediary may not amount to more than half the sum of the brokerage commission and the total renewal commission for the insurance concerned (Article 150, Bgfo).[15] The renewal commission should be paid pro rata throughout a ten-year period at the least – or for a shorter period according to the term of the policy. The purpose of this is to put in place a balance between brokerage commission and renewal commission where previously the market operated to a significant degree using brokerage commission for complex products. This measure seeks to bring about a better connection between an intermediary's remuneration and his performance; it prevents effecting as many contracts as possible as quickly as possible in order to receive as much brokerage commission as possible ('commission hunting'), and it reduces transfer costs for the consumer, as well as the incentives for recommending unnecessary policy renewals on different conditions or for transferring a policy to another insurer. In part, brokerage commission includes advance remuneration for future services. If a policy is terminated prematurely (within five years), the *commission refunding rule* applies. There will be a proportional reduction in brokerage

[12] This decision was adopted on 12 October 2006 and was most recently amended on 16 September 2009.
[13] This decision was adopted on 9 December 2008 and was most recently amended on 16 September 2009.
[14] This decision was adopted on 9 December 2008 and has not been amended since then.
[15] This decision was adopted on 12 December 2006 and was most recently amended on 16 September 2009.

commission in the event that an agreement for a complex product or mortgage loan is terminated prematurely as a result of unnatural wastage within at least five years (Article 151, Bgfo).[16]

- *Appropriate commission (inducement standard)*: to safeguard that the adviser/intermediary is acting in the interests of the customer, the inducement standard prohibits commissions (within the meaning of Section 1:1 of the Wft, 'remuneration or payment whatever its form') for activities that 'are unnecessary in order to provide the service concerned or that makes this possible'. The inducement standard is an open standard that prohibits commissions, unless they are transparent and do not conflict with the customer's interests.[17] An important expression of the inducement standard is the bonus ban (Article 149a, paragraph 3, Bgfo). After all, a volume-related bonus does not relate to a service for an individual customer. The inducement standard thereby forbids 'perverse' forms of remuneration – such as volume-related bonuses – that can lead the adviser/intermediary to providers and/or products where such forms of remuneration have not been optimally tailored to the demands and circumstances of the consumer in question (Article 149a, Bgfo).[18]

Table 2.2 provides an overview of the commission rules that are at the centre of the present study. Each line indicates the information-related problem that is being solved.

Table 2.2 Intended effects of each commission rule

Rule	**Bgfo article**	**Desired conduct**	**Effect (numbers refer to Figure 1.2)**
Remuneration transparency - Adviser/intermediary's services statement - Provider's qualitative statement of costs	Art. 58, para. 1 Art. 149b Art. 58, para. 3	• Adviser/intermediary/provider furnishes consumer with the services statement, which informs the customer about services and fees • Customers inform themselves better about advisers, intermediaries, providers and products	Solving information problems (2) and (4)
Balancing rule and Commission refunding rule	Art. 150 Art. 151	• Adviser/intermediary acts more in the consumer's interest • Adviser/intermediary does not allow himself to be led by a provider and/or product bias • Remuneration for the adviser/intermediary is more in line with his efforts	Solving information problems (4), (5) and (7)
Inducement standard	Art. 149a	All of the above	Solving information problems (2), (4), (5) and (7)

Source: SEO Economic Research

2.5 From theory to practice

Chapter 2 provides an overview of the policy theory underlying the commission regulations. That theory pursues two main points: (i) in a market with a high degree of information asymmetry,

16 This decision was adopted on 12 October 2006 and was most recently amended on 9 December 2008.

17 *Merriam-Webster Online Dictionary: 'inducement' suggests a motive prompted by the deliberate enticements or allurements of another motive, "offered a watch as an inducement to subscribe".*

18 This decision was adopted on 9 December 2008 and was most recently amended on 9 December 2009.

players – particularly consumers – are unable to make any considered decisions and (ii) wrongful remunerative incentives induce players to indulge in conduct that is not in the consumer's interest. These factors are connected: if the remunerative incentives are not in the consumer's interest, the supplier (either the intermediary or the provider) will be disinclined to inform the customer about price and quality, leaving the information imbalance intact. Vice versa, it will be worthwhile maintaining perverse remunerative incentives if the availability of information is lopsided.
With these considerations in mind, rules have been enacted aiming at reducing information asymmetry and removing perverse remunerative incentives. These rules are instruments for the purpose of strengthening the consumer's position, manifesting themselves in the form of appropriate products and services that are also appropriately priced.

An evaluation involves questioning whether these rules are being observed and whether its instruments are leading to achievement of the objective. If the instruments are not working as it was hoped they would, this then raises a supplementary question: why not? Does the problem lie with the instruments themselves, or are the conditions not being met under which they should be able to work? The fact is that regulations aimed at informing consumers are of use only if the message actually comes across to consumers and if they convert that message into action. The above is represented in Table 2.3.

Table 2.3 Stratification within the formulation of the problem

	Transparency	**Commission**
basic problem	inappropriate products	inappropriate products
explanations	badly informed customers	perverse incentives
instrument	obligation of transparency	commission restrictions
evaluation question 1	*are market players keeping to the rules?*	
intended effect	better informed consumers	customer interests are put first (or to a greater extent)
evaluation question 2	*Are the intended effects in evidence?*	
condition for success	cultural shift: customers take the information	cultural shift: from customer-driven to product-driven; customer can provide counterbalance
evaluation question 3	*are market players and consumers adopting a different attitude?*	
objective	more appropriate products	more freedom of choice
evaluation question 4	*does the market work better?*	

One difficulty is that the basic problem (mis-selling) cannot be measured (see also Box 2.2). As a result, the formulation of the problem focuses inherently on aspects that derive from this: is the market operating better, are the players involved making the desired cultural shift and are the players keeping to the rules? These questions are answered based on the two instrumental lines: transparency rules and commission rules, in this case the balancing rule and inducement.

The basic questions with regard to **transparency** are as follows:
- are customers effectively informed about the services they can expect and about the cost of those services?
- if so, does this transparency result in consumers who are more vocal and critical?
- if so, do consumers who are more vocal and critical result in better advice and greater freedom of choice?

The basic questions in the case of **commission restrictions** are as follows:

- have perverse remunerative incentives disappeared from the market?
- have substitute remunerative incentives replaced them with comparable undesirable effects?
- does a remuneration structure without perverse incentives result in better advice, an expansion of supply and greater freedom of choice for the customer?

Since there is a connection between transparency and the existence of perverse incentives, those questions are also answered in connection with each other.

2.6 Scope of the research

The regulations evaluated in this study have been introduced and amended in a number of stages. The commission regulations form part of a broader package of requirements for advisers and intermediaries that have been laid down in the Wft, such as a demonstrable duty of care, professionalism, integrity and an administrative organisation that operates with propriety. These requirements also have an impact on financial advisers' business practices and, as a result, on the market as a whole. Since it has still only been a short while since the introduction of the commission rules, their effects have not yet materialised to their full extent. Consequently, the distribution chain for complex products, mortgage loans, unemployment payment-protection policies and funeral insurance is in a transitional phase.

Unfortunately, a benchmark measurement was not taken to indicate either how weak the consumer's position was under the former regime or the degree to which mis-selling an/or excessive remuneration was present. Therefore, this evaluation cannot compare anew situation with an old one.

Box 2.2 Mis-selling

A complicating factor is the absence of a benchmark for mis-selling. Interviewees univocally endorse the importance of reducing mis-selling, but it is also acknowledged that its (objective) measurement would be exceptionally challenging.

Strictly speaking, mis-selling relates to issue of whether recommended and sold financial products suit a customer's income, financial position and attitude to risk, and whether the products have been reasonably priced. The regulations envisage the creation of circumstances to guarantee that advisers/intermediaries serve customers' interests. The guarantee runs in part through the strategy for professionalism (so that the adviser is sufficiently equipped to come up with appropriate advice) and in part through the remuneration strategy (lest the adviser be tempted to issue an inappropriate recommendation).

Within the terms of supervision as exercised by the AFM, advisers need to show that they have inquired with probity about their customers' relevant circumstances and distinguishing characteristics. However, the regulations do not discuss the content of the advice or the product itself.[19]

[19] Bruggert *et al.* (F. Bruggert, N. van der Lijn & A. Meijer, 2004, *Marktwerking op de market voor hypothecaire kredietverlening*, Rotterdam: Ecorys) made an attempt to gauge the suitability of recommended products. The advice from the comparison website Independer is reconstructed retrospectively for recently arranged mortgage loans from households living in newly built quarters]. The degree of suitability of the type of mortgage actually selected is defined in terms of deviation from the Independer recommendations.

The question at issue in the evaluation is whether the regulations have had an impact vis-à-vis better safeguarding the interests of the customer. To that end, the evaluation looks at how the regulations operate, i.e. the mechanisms in the market for acting as the intermediary for complex products, and not at the advice and recommended products themselves.

In addition to this, the financial products market is in considerable flux. The commission rules are not the only exogenous factor to have changed. Alongside the regulations, certain developments are affecting the market and its players greatly: the economic crisis and the new avenues of communication and information, the most important expression of which is the internet.

The crisis

The economic downturn that began in 2008 and from which the global economy is now recovering was partly caused by matters getting out of hand with regard to the sale, division and re-bundling of packages of mortgage loans in the United States. A significant consequence of the credit crisis in the Netherlands was a large part of the housing market coming to a standstill. Property sales in 2009 were approximately 40% down on the previous year, while selling prices also came under pressure. The bottom has fallen out of the market for mortgage loans and related products, such as life insurance, and, for the time being, shows little sign of regeneration. The result is an immediate downturn in the turnover of intermediaries and advisers. Added to this is the option for bank saving as an alternative for life insurance with mortgages (since 2008), the volume of which witnessed enormous expansion in 2009, possibly at the expense of products that might have come under the heading 'mis-selling'.[20]

On average, 20% of of turnover of *mainstream* insurance brokers derives from life policies and mortgages. For these firms, approximately ten percent of the turnover generated by disappeared as a result of the crisis. For mortgage advisers, whose existence is almost entirely based on life policies and mortgages, a reduction of 40 to 50% of turnover is a serious threat for continuity, that can be addressed only through scaling down. This had led to the termination of business activities, whether enforced or otherwise. The decline of the mortgage and life insurance market means a hardening of the competitive environment in which prices are coming under pressure. As the market shrinks, the more difficult it is for businesses to hold on to existing customers or to recruit new ones. One beneficial side-effect of these circumstances is that it compels players to develop a more customer-focused attitude.

Internet

Electronic communication is making the world smaller and is reducing the cost of sharing information and of effecting transactions. The debate about *disintermediation* (cutting out the middleman) has been ongoing since the internet was in its infancy, but in recent years this phenomenon has taken on a more realistic aspect. The communication opportunities afforded by the internet are now becoming mature.

Various mechanisms in the insurance market are responsible for this development putting the intermediary's position under fundamental pressure. Firstly, it is easier for insurers and policyholders to get into direct contact with each other, thus lessening the importance of one of the intermediary's functions: that of acting as a channel of communication between the insurer and

[20] Central Bureau of Statistics press release, dated 27 April 2010.

policyholder. This results in new relationships between the various distribution channels: the barrier has lowered for insurerers to reach customers via *direct writing*. There has been a disruption of the equilibrium between the intermediary channel and the direct writing channel as a result.
In addition, the internet is making markets – theoretically – more transparent. It becomes easier to compare different insurers' products, prices and conditions. A variety of internet companies provide comparisons between the products of a range of insurers. By so doing, yet another function of the intermediary is put under pressure: that of the adviser who (pre-) selects various products and guides the customer towards one that is appropriate.

The selection and taking out of an appropriate insurance policy is increasingly just a matter of a few mouse clicks. Up until now, transactions concluded via the internet in the complex financial products market have remained extremely limited in scale. That is not to say that the improvements in information and communication opportunities have not had their repercussions in that market too. Consumers have the opportunity to get their bearings in advance and, as a result, to gain an impression of the options on offer to them in the market.

A consequence of this development for advisers (and for insurers and customers) is that the divisions between information gathering, consulting and intermediation are becoming ever more manifest. The job and role of the adviser/intermediary as the link between providers and consumers is changing. This places the entire intermediary business model under review. The CAR debate currently underway derives in part from this situation of rearrangement.[21]

Regulations, the crisis and the internet

The regulations as they have evolved over recent years have had an undeniable effect on the market. Nevertheless, it is clear that the other forces at play have had a very substantial and often still greater impact. The crisis and the internet are encroaching on approximately the same areas in the market as regulation (restricting the freedom of scope enjoyed by the market players) and often in the same direction as well. Observed behavioural changes may be either the direct or indirect result of the regulations or else of the crisis or of changing technology – or a combination of all three.

The interpretation of a quantitative study focussing on the impact of amended regulations is made more complicated against this background. The regulations are recent in date and, moreover, are still in the process of being implemented. There is insufficient 'hard' statistical data about the behaviour of the parties involved in order to present an unequivocal picture of behavioural change or in order to provide evidence of a relationship between regulations and changes in the market using a properly substantiated econometric analysis. That hard data does not exist, nor will it be forthcoming (for the time being). A multitude of points of view and indicators have been collected together in the research forming the basis for this report. Taken together, these points of view and indicators will provide a picture of changes in the market.

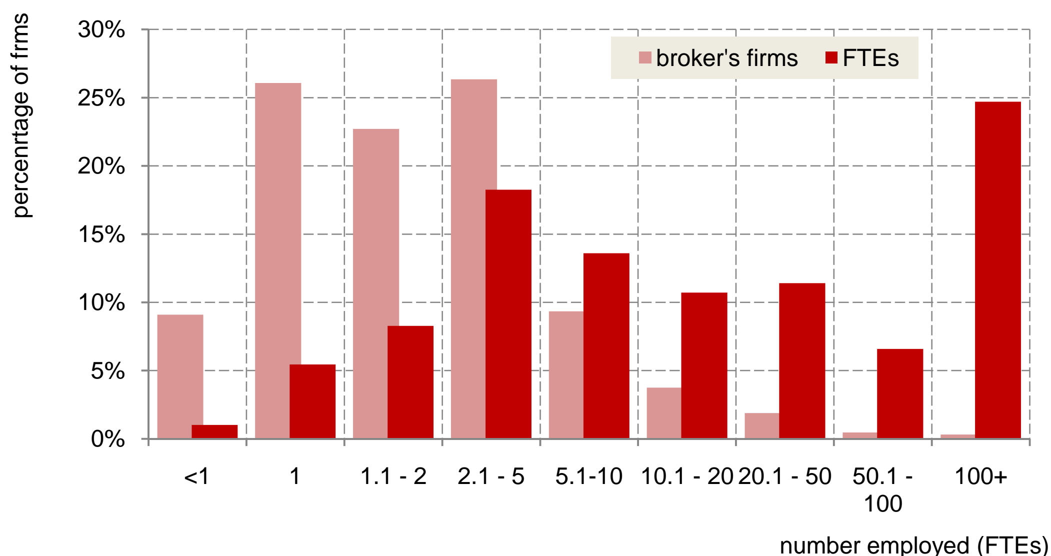
[21] CAR stands for *Customer Agreed Remuneration*, a system in which the remuneration for intermediary activities (recommendations and sales) is agreed between the intermediary and the customer.

3 Market outline of advisers and intermediaries

After making adjustments for businesses only with an authorisation permit or provider's licence (and taking May 2010 as the reference date), the AFM's register contains 8,913 companies and individuals licensed to act as advisers and/or act as intermediaries for financial products.[22] 8,475 of these are licensed to act as advisers and/or act as intermediaries for life insurance, while 7,362 are licensed to do the same for mortgage loans. Not all of the licence holders use their licence.

The majority of licence-holding companies are small, despite all the increases in scale evident over the past few years: half of them have fewer than two full-time jobs (see Figure 3.1), 84% have fewer than five. These companies close to their customers, with a local or regional service area.

Figure 3.1 Most broker's firms are small ; half the jobs in larger firms



Source: StFD, SA 2009, adapted by SEO

Expressed in terms of the number of jobs (which correlates strongly with turnover) the largest part of the market lies with the larger businesses. Almost half of the total jobs are at broker's firms with more than ten FTEs; the small group of 100+ companies accounts for a quarter of all jobs.

More than 20% of the licensed firms are members of one or more of the professional bodies that concentrate on representing collective interests, e.g. through lobbying. This relates chiefly to the larger firms. 72% of the licensed firms are affiliated to one or more service organisations that focus on achieving financial gain, such as purchasing consortia or franchise chains. At 62% of the

[22] This is considerably more than the 5,505 firms reported by the Central Bureau of Statistics based on business surveys and random checks (ABN AMRO, *Visie op sectoren – Assurantietussenpersonen*, http://www.abnamro.nl/nl/zakelijk/sectoren/zakelijke_dienstverlening/brancherapporten.html - [Overview of sectors – Insurance intermediaries]). In the present case, the designated path to take seemed to be that of the AFM and the StFD, which serves more than 8,000 firms).

firms, (at least) one person is employed who has been certified by one of the (many) qualification systems.

Over the past few years, the number of those leaving the market has been relatively high. This has been partly due to bankruptcy, but in the main it has been due to (older) entrepreneurs disposing of their portfolios. This trend was also caused by increased requirements imposed on intermediaries by the Wft.

4 Findings

The evaluation study involved the consultation of a large number of sources. This chapter presents the findings based on the questions concerning the extent to which the regulations are being observed in the market and whether the regulations are having their intended effect.

4.1 Internalisation of the regulations

The Financial Services Act came into force in 2006. Since then, its regulations have been extended and tightened several times. A broadly based picture emerges from the interviews that the current regulations were created in the form of an accumulation of responses to market abuse. The news about 'extortionate policies' and the commission structure of a company such as DSB led to a chain of incident-driven amendments. A complex structure of legislation and regulations has arisen as a result of this, one that is not felt to be easily accessible and not always consistent in all areas.[23] Several respondent note regulations appeared in haste and that the players have been given little time to adjust to them.

The financial sector is traditional in nature and is one that, until recently, was subject to little dynamics. Its relationships and models are entrenched and, consequently, not easy to alter. In part due to the sector's own advocacy, the legislation has been clad with 'open standards', which means that market players can determine themselves how to deal with general requirements. It now appears that – partly thanks to the sector's traditional character – the players are having difficulty in finding a way to interpret the new regulations on their own. There is a demand for specific guidelines. With that in mind, they are looking to their collective organisations, such as the Netherlands Association of Financial Intermediairies (Adfiz) and the Netherlands Association of Insurance Companies, as well as to the supervisor, the AFM. This is why the diversity that was the aim of these open standards has barely got off the ground. A restriction of diversity is more the case when the market players translate the open standards into policy and action on a collective basis and in the same manner.

It would seem from the interviews that the observation that the market has little time to adjust to the new rules needs putting into perspective. Despite the need for guidelines, the sector has mostly responded in dismissive terms to expanding or amending the regulations, and little account is taken of the advance announcement of new measures. As a result, the sector exhibits little proactive behaviour and, as a rule, reflects on the consequences of amendments to regulations or change in the outside world only once these matters actually arise. The capacity to anticipate events is limited.[24]

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23 Some of the descriptions to emerge from the interviews: 'unclear', 'massive', 'inaccessible', 'illogical', 'a hotchpotch', 'not in harmony with the Markets in Financial Instruments Directive (MiFID)' and 'unworkable'.

24 One mitigating circumstance is the extremely limited business size of many insurance and mortgage brokers. Companies are no less enterprising for being limited in size, nor are they more averse to change, but this does contribute to a restricted scope and to a dependence on the information provided by professional bodies and other collective channels.

Box 4.1 Low-level anticipation of the services statement

The obligation to hand over a *services statement* when providing advice and acting as an intermediary for complex products was introduced on 1 July 2009 and was announced well in advance. In a survey of insurance firms in April 2009 (SEO/Assurantiemagazine, 2009), a third of the respondents still had no idea about what such a document should contain. A majority did have the impression that the document would not affect the quality of service provision. Ignorance was chiefly among the smallest firms (Table 4.1). More than half the small firms revealed that they would be consulting standard models for the content of the services statement they were to compile and that they were awaiting the appearance of these models on the market.

Table 4.1: Familiarity with the services statement (April 2009)

Business size (employees)	1-2	3-10	11-25	25+	Total
% yes	55	70	80	72	67
% no	45	30	10	28	33

Source: SEO/Assurantiemagazine 2009

It is noted from various quarters that the market players in the sector have a natural inclination to uncover escape routes within the new rules that will enable them to continue as far as possible with their existing practices. The regulations are read through word for word by those who are adept at seeking out exceptions. Meanwhile, the regulator (for which read 'the AFM') anticipates the 'workarounds' that the sector could create by aiming to fully cover situations that might arise through guidelines and other releases. As a result of this, a network of rules and minimum requirements that have to be met is gradually replacing the philosophy of open standards. This is why the complexity of the regulations can also be seen as a consequence of the market players' inclination to look for loopholes in those regulations.

In response to the accumulating regulations, many company are translating compliance into a culture of checklists. Liability is covered if there is compliance with the requirements. A change in behaviour thus is legally inspired, rather than being internalised. As one of the respondents remarked: 'the intermediary doesn't see the services statement as a business card but as a necessary evil'. A consequence of this is that, rather than the intended cultural shift in which the customer's interests become the naturally driving force, what appears instead is a mechanism for reverting to minimum requirements. This reinforces the aforementioned process of adverse selection, which can result in a reduction in quality and increasing uniformity of supply.[25]

Box 4.2: More to the letter of the law than in its spirit

After the commission regulations for complex products came into force, part of the sector responded by putting their money all the more on mortgage-related products, such as unemployment payment-protection policies and funeral insurance. Since these types of insurance remained

[25] The reversion to minimum requirements, and the related risk of adverse selection, is also mentioned in response to the requirements (falling beyond the scope of this study) in respect of professionalism and continuous education. Consumers cannot evaluate the added value of a properly and continually trained adviser, and advisers can set themselves apart only on the basis of price differences. Intermediaries – as well as their employees – lack an incentive to invest in high-quality knowledge, as they would price themselves out of the market as a result. It has been observed from various quarters that this mechanism is already in evidence, causing a decline in the average level of professionalism.

beyond the scope of the regulations, it was still possible to receive bonuses for them. This changed only once payment-protection and funeral insurance policies were brought under the complex products regime.

A comparable response arose following the coming into force of the Bgfo on 1 January 2009. Lively debate subsequently ensued in the market concerning whether pensions would also come under the new regulations. Only following clarification by the AFM and the Ministry of Finance did all of the parties go along with pension products also coming under the regulations.

There is a strong communis opinio that the AFM hholds a strong grip on the market. The supervisory regime is 'feared', the penalties can be high and it is assumed that once the supervisor has a firm in its sights its attention will be fixed forever. It is noted on all sides that people are troubled by the role of regulator, investigative body and judge all in one organisation. Not only does this lead to a (supposed) merging of roles but also to long-term procedures, to sanctions concerning old cases, which produces little in the way of a preventive effect, and to a situation where it is impossible for the supervisor to share information with other parties, which from a preventive or early-warning perspective is precisely the thing that would be so useful.

Conclusion: *The traditional character of the sector and the system of entrenched models prevent market compliance from being taken up quickly and enthusiastically. The regulations are perceived to be inaccessible, and the open standards are turned into uniform checklists. Compliance is not internalised; there is (as yet) little sense of the desired cultural shift.*

4.2 Familiarity with the regulations

Among intermediaries

The 2009 self-assessment of the Stichting Financiële Dienstverlening (StFD, *vide* Appendix B.4) (held in the summer of 2009) surveyed the extent of familiarity with the new commission regulations: 87% indicated they were 'fully' aware (Table 4.2), 12% that they were 'partly familiar' and a small group was 'unfamiliar'.[26] Familiarity with the commission regulations varies according to the brokerage firm's size. The larger firms, with ten employees or more, felt that they were well informed. The problem lies chiefly with the small firms, of up to three employees – jointly accounting for 63% of the total number of firms in the market.

Table 4.2: Small broker's firms show greatest detachment from the regulations

Familiarity with commission rules (%)	1	1-3	3-5	5-10	10-20	20-50	50+	Total
% unfamiliar	5	1	0	1	1	0	0	1
% partly familiar	12	14	10	8	6	5	3	12
% fully familiar	82	85	90	91	93	95	97	87

Source: StFD 2009, adapted by SEO

[26] These figures relate only to those firms that actually realised turnover from complex products. The extent to which respondents were actually familiar with the regulations was not examined. Most of the people interviewed were of the opinion that the inducement rules had not yet touched down properly in the market.

It has already been noted above that the market players are strongly inclined to look to their collective organisations where knowledge and the implementation of (new) legislation and regulations are concerned. This view is confirmed through differentiation according to membership of (relevant) professional bodies and partnerships, e.g., franchise chains or purchasing consortia. Table 4.3 shows how the 'horizontally arranged' players are better informed than those who operate on a stand-alone basis. It should be noted in this regard that firm size also plays a role. The professional bodies represent mainly the somewhat larger firms, in ths industry that means from three employees upwards.

Table 4.3: Collective organisation playing a role in disseminating knowledge

Familiarity with commission rules (%)	Not members of professional body	Member of professional body	Not affiliated to a partnership	Affiliated to a partnership	Total
% unfamiliar	1	0	2	1	1
% partly familiar	13	7	16	10	12
% fully familiar	86	92	82	90	87

Source:StFD 2009, adapted by SEO

Remuneration transparency

The figures from the survey among intermediaries conducted for this study (Summer 2010) yield a slightly less positive picture.

The services statement has been mandatory since 1 July 2009. 84% of the broker's firms surveyed in the study indicated that they were familiar with the ins and outs of the services statement (Table 4.4). 14% rated their own familiarity with it as 'reasonable', and only one or two went no further than saying 'some' or 'hardly any' familiarity. In this case, too, it is chiefly the small firms that are lagging behind.

Table 4.4: Familiarity with the services statement

Company size (employees)	1-2	3-4	4-10	11-30	30+	Total
% hardly any	1	1	0	0	0	0
% some	2	1	0	0	0	1
% reasonable	17	12	12	8	4	14
% well familiarised	81	86	88	92	94	84

Source: SEO/TNS Nipo 2010

Balancing rule

The balancing rule operates largely beyond the consumer's sight and is chiefly implemented through the insurers. Although the intermediaries notice direct consequences from the balancing rule in their cash flows, familiarity with the rule is at a lower level than that for the services statement. Less than three-quarters indicate that they are well familiarised with the new balance between brokerage commissions and renewal commissions (Table 4.5). As before, it is the smallest players who remain behind.

Table 4.5: Familiarity with the balancing rule

Company size (employees)	1-2	3-4	4-10	11-30	30+	Total
% hardly any	3	1	0	0	0	2
% some	7	5	2	0	0	5
% reasonable	22	20	22	13	11	21
% well familiarised	68	73	76	87	89	72

Source: SEO/TNS Nipo 2010

The relatively low level of knowledge about the rule among smaller firms is notable, given that this rule is at the very least an open standard: the balance between brokerage commission and renewal commission is clear, and insurers should be compliant with it. It seems illogical for proefessionals to have no idea about the background of changing liquidity flows – not only for the purpose of checking actions taken by insurers, but also in order to estimate their own (future) liquidity position. It follows from this, and is also of great importance to the impact of the regulations, that a lack of knowledge of this type also implies limitations on the functioning of the (envisaged) incentives for after-sales service.

Inducement

The AFM's *Appropriate commission guidelines* (August 2009) have received a fair amount of criticism from the market, in terms of the document's accessibility and manageability; and, according to the interviewees, it is not heavily read either. Therefore, it is a bit of a surprise that the regulations concerning 'appropriate commissions' appear to have taken root to a reasonable degree. Three-quarters of the broker's firms indicate they are well familiarised with the guidelines, while 20% say they are reasonably familiar with them (Table 4.6). Here, too, we see the familiar picture of larger firms feeling that they are better informed.

Table 4.6: Familiarity with 'appropriate commissions'

Company size (employees)	1-2	3-4	4-10	11-30	30+	Total
% hardly any	1	0	0	0	0	1
% some	5	4	0	1	0	4
% reasonable	23	18	22	7	14	21
% well familiarised	72	78	78	92	86	75

Source: SEO/TNS Nipo 2010

A recurring observation from the above is the shortfall in knowledge among the very small-scaled firms. The AFM rightly notes that firm size is not a prerequisite for a shift in culture, and that there are many small firms operating on the basis of quality and entrepreneurship, just as there are large firms that perform worse. It should be mentioned in this regard that the figures presented in these instances concern knowledge rather than attitude. That knowledge is crucial if attitudes are to change business practice. The dividing line is not so much between 'small' and 'large' (virtually the whole sector is small in staaistical terms), but between 'very small' and 'larger'.

Among consumers

Familiarity is still lacking among consumers. A little under half of the consumer survey's respondents – selected on the basis of having acquired recently a complex product, or at least having sought to do so– indicate that they knew in advance that they had to be supplied with information about services and costs. However, it is telling that a quarter of the respondents indicate not to remember (any more) whether the document had actually been handed to them. This applies both to consumers who made purchases or inquiries through intermediary channels and to customers who chose for the direct-write channel.

By and large, this lack of familiarity was confirmed in the interviews. Although the sector seems compliant with the requirement to furnish the services statement, the consumer still shows little awareness of this mandatory component or of its use.

Conclusion: *The services statement and the qualitative statement of costs are not (yet) among the expectations of consumers who are in the market for complex financial products. For intermediaries and providers, it appears to have become standard practice to operate with such a document. Among intermediaries, familiarity with the regulations concerning brokerage commission and renewal commission and concerning appropriate commissions is reasonable to good. Across the whole spectrum, it is the small firms that are the least informed.*

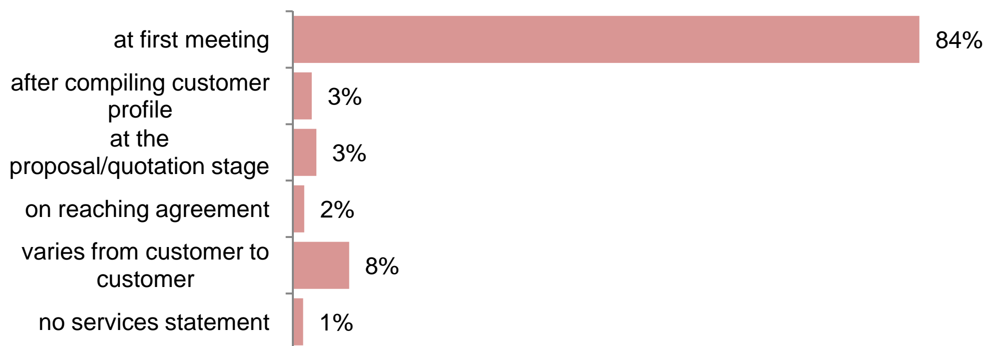
4.3 Interpretation of remuneration transparency

Remuneration transparency means that, during the pre-contractual phase, the customer is entitled to insight into the way in which the adviser/intermediary is paid for the recommendations about and/or the sale of a financial product, as well as the amount of remuneration involved (Article 58, paragraph 1, Bgfo). Insurers advising and selling direct to consumers have to indicate their distribution costs, as well as the nature and scope of their services (Article 58, paragraph 3, Bgfo). After all, remuneration transparency without transparency of services is a meaningless concept. An important related instrument is the services statement, which advisers/intermediaries should provide to the consumer at an early stage in the process. The document explains what their services consist of and how they are paid for those services (Article 149b, Bgfo). Providers need to furnish a qualitative statement of costs.

The time of presenting the documentation

Bgfo requires the services statement to be supplied during the pre-contractual phase. A majority of the intermediaries (84%) indicates that they supply the services statement at the first meeting (Figure 4-1). 3% wait until they have drawn up the customer profile. 8% does not have a set time for handing over the services statement. 5% of the intermediaries wait until the quotation stage or whenever verbal agreement is reached about products and services. This group, consisting chiefly of small and very small firms, rather stretches the meaning of 'pre-contractual'.

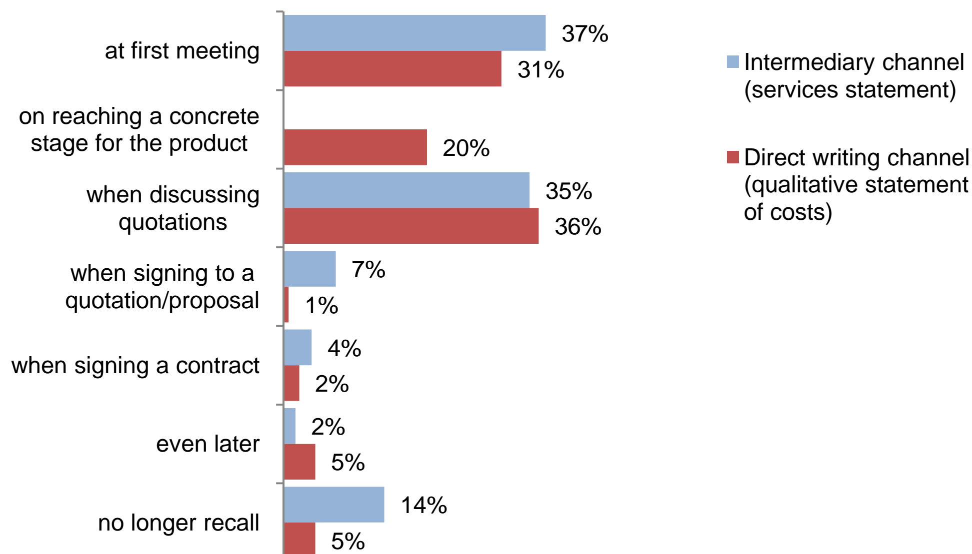
Figure 4-1: According to intermediaries, the services statement is usually supplied at the first meeting



Source: SEO/TNS Nipo 2010

Customers' perceptions differ from those of intermediaries. Of the consumers who were aware of having been extended a services statement (qualitative statement of costs), more than a third indicated that this occurred at the first meeting (Figure 4-2), with a further third saying that it happened when suppliers' quotations came up for discussion. 14% could not recall the precise moment. 13% indicated they had received the services statement only at the time of signing or when signature was required.

Figure 4-2: According to consumers, the services statement is often supplied only once the matter in hand becomes concrete



Source: SEO/TNS Nipo 2010

The difference in perception between intermediaries and consumers may possibly derive from interpretations of what constitutes the 'first' meeting. It emerged from a number of interviews that it would be awkward to provide clarification about services and costs at a very early stage in the consulting process, because the products or recommendations that (potentially) interest the customer would still remain unclear. At a first meeting, mortgage customers in particular mainly want a quick indication of their borrowing capacity. In the service industries, a relationship is

built up between the (potential) supplier and the customer before business is done. Firms indicate that they would only really be able to discuss the subject of services and costs somewhat later in the consulting process – and, at any rate, not when making first contact. This consideration does not correspond with the 'menu' concept underlying the services statement: just as a customer going out to eat can peruse a restaurant window menu for its dishes and prices, so an insurance customer should be able to see what the intermediary concerned has to offer from an equivalent distance.

The strategy of handing over the services statement during a subsequent meeting, at a time when specific products are being discussed, can be viewed as a 'lock-in' strategy. The consumer invests time and energy in the relationship with the intermediary and, as a consequence, feels there is a barrier to going off in search of advice yet again once he has received information about costs and services.

Regarding those customers who recalled having received a services statement (or qualitative statement of costs, as the case may be), the great majority (90% in the case of the intermediary channel; 80% in the case of direct writing) indicated that the document was supplied at the intermediary's (and/or provider's) own instigation. 10% of customers had to ask for it themselves in the case of an intermediary (20% in the case of a provider).

***Conclusion**: Intermediaries, providers and consumers have differing perceptions about the time at which the services statement or qualitative statement of costs is handed over. A large group of consumers indicates that they having received the document late in the pre-contractual phase or even later still. This does not comply with one of the documents' objectives – providing information in advance about prices and services – and it restricts the consumer's mobility.*

Transfer of information and the services statement

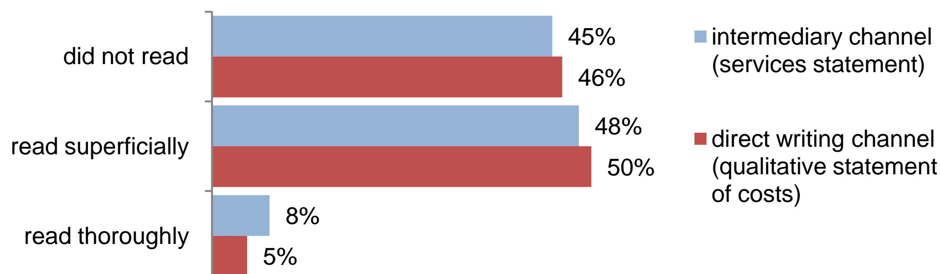
A commonly heard observation is that the services statement and qualitative statement of costs 'disappear within a great stack of paperwork'. A factor when acquiring, terminating or renegotiating complex financial products or else insuring them elsewhere is that this activity usually arises at a time of relatively high emotional impact on the lives of consumer households: the purchase and sale of a home, moving house, a change to the make-up of the household (divorce is a significant driver for changes to the living situation and changes to current financial products), etc. The consumer attaches priority to these events above details concerning the corresponding financial transactions.

In addition to this, complex financial products generally entail a large amount of documentation. As a rule of thumb, a consumer taking out a mortgage loan with life insurance will build up a personal file amounting step-by-step to roughly thirty documents, which jointly include 200 to 250 pages of material. The danger of information overload is reputed to be a significant factor concerning complex financial products: the consumer is unable to see the wood for the trees and, instead of absorbing additional information, responds by ignoring it. Research on behalf of the British Financial Services Association, in which various types of disclosure were measured, en-

dorses this view.[27] Having too much detail in the information is perceived as more objectionable than having too little. Van Raaij (2008) also points to this: more information and greater freedom of choice do not necessarily lead to happier customers.[28]

The Home Owners Assocation *Vereniging Eigen Huis* observed in April 2010, albeit on the basis of a very small sample (n=24), that a great diversity exists in the way in which the services statement is interpreted and that, as a result, any comparability and thus practical value for the consumer are to no avail.[29]

Figure 4-3: A minority of consumers read through the information about costs and services thoroughly



Source: SEO/TNS Nipo 2010

This view is confirmed in the consumer survey. Of the consumers who are aware of having received a services statement, 45% said not having read it at all (Figure 4-3), 48% having read it superficially and only 8% reported having studied the document thoroughly. The percentages for the qualitative statement of costs in the direct writing channel are little different.

Consumers who familiarised themselves with the services statement, indicate that they feel well informed about the services (75%) and the manner of remuneration (68%) for the intermediary/adviser. Consumers appear to make no distinction between how the intermediary's remuneration was determined and the amount this remuneration ultimately came to. This may have to do with the fact that commission (in the sense of percentage multiplied by premium) is the most customary form of remuneration: the statement concerning the form and amount of remuneration is submitted in one notification, and the customer does not distinguish the difference between the calculation method and the resulting amount.

This explains the great decline in the flow of information: a considerable proportion of consumers did not note having been given information about remuneration and services. Of those who did, more than half did not study it seriously.

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27 British Financial Services Authority (2008), *Services and cost disclosure – Qualitative research with potential and recent purchasers of financial products*, Research report prepared by BMRB Social Research.

28 W.F. van Raaij (2008), 'Financieel toezicht en de consument' *[Financial supervision and the consumer]*, in: *Dossier Financieel Toezicht*, ESB **93**(4543S), pages 29-33.

29 Vereniging Eigen Huis, *Resultaten: Dienstverleningsdocument [Results: Services statement],* Amersfoort, April 2010.

By their own admission, half of consumers are unable to assess whether the remuneration is in line with the efforts made by the intermediary on their behalf. Of those who are able to make that judgment, two-thirds indicated that the remuneration was in line with efforts made; a remaining third disagreed.[30]

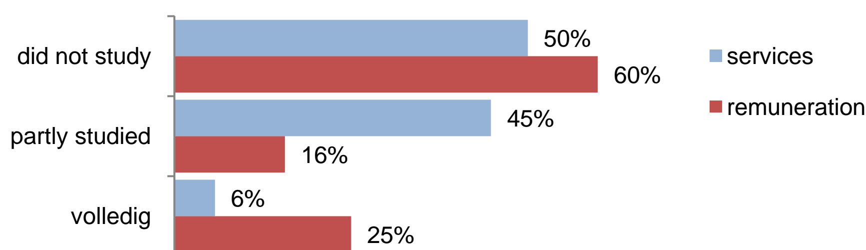
When interviewed, the providers, advisers and consumer representatives all indicate that they consider the services statement to be a useful instrument. A less univocal view emerges from the question of whether or not the objective of transparency had been achieved. The professionals consulted in the interviews may have allowed themselves to be led by the *potential* use of the services statement, while its material use continues to rebound against matters such as information overload and disinterest on the part of the consumer.

***Conclusion**: The prevailing notion that the consumer has no real interest in what an intermediary is costing him is confirmed with regard to the majority of consumers. The services statement and qualitative statement of costs play a limited role for the consumer when respectively gathering information or being informed. Nevertheless, consumers who study the document in depth indicate that they have been effectively informed. For the customer to be empowered, it is necessary not only to inform the customer properly, but also that the customer is prepared to go through that information. The distinct impression is that the services statement and qualitative statement of costs in their present form are not instruments which encourage consumers to do that.*

Effect on decision-making behaviour

The study group's consumers who had recently acquired a financial product had not comprehensively sought out comparisons beforehand. Of the households that employed the intermediary channel, 78% limited themselves to contacting one intermediary. Of the 22% who did shop around, two-thirds consulted two intermediaries, while the remaining third consulted three or more. It is true that half of consumers said they had also directly sought out providers (in the main, one or two), but that they had still decided on an intermediary in the end.

Figure 4-4: Consumers study intermediaries' costs and services in advance only to a limited extent



NB based on the 22% of customers who actually shopped around

Source: SEO/TNS Nipo 2010

[30] TNS Nipo's own research reveals that there is a considerable discrepancy between the time that intermediaries allege they have spent and the time that customers think is necessary. Mortgage advisers work on the premise that 20 to 30 hours will be spent on each mortgage file; customers estimate the amount of time spent as being approximately 12 hours (TNS Nipo press release dated 18 August 2010, further to *Onderzoek provisiebeleving consumenten* [Research paper on consumer perception of commission]).

Of the households to have purchased a product from a direct writer, 30% had been to see an intermediary and 40% had reviewed products from more than one provider.

The customers who examined more than one intermediary were not primarily guided when doing so by information on the intermediary's services package (Figure 4-4). 6% report having studied the services in depth, while 45% had done so only to some degree. For half of the customers, the services package did not constitute an explicit component of their search – which probably indicates an advance assumption that there would be little difference between them.

The total number of customers having examnined the intermediary's costs in advance was somewhat lower than that for those who had looked at the nature of services on offer. However, this group did appear to be more adept: a quarter of them assumed they had been fully informed, while one in six felt they had partial information.

The intermediaries surveyed for this study do not indicate either that customers show more signs of having shopped around since the introduction of the services statement. Consequently, the information in the services statement has a limited effect on consumers' decision-making behaviour.

In respect to channel choice (via an intermediary or direct contact with the insurere), the choice for a particular intermediary, a particular product or a particular insurer, a large majority of the consumers indicates that the information in the services statement has had little or no effect on the decisions that they took see Table 4.7.

Table 4.7: Limited effect of transparency on behaviour

	Information about services		Information about remuneration	
Decisive factor for:	% decisive	% a consideration	% decisive	% a consideration
choice of channel	13	16	9	17
choice of a particular intermediary / provider	14	20	23	25
choice of a particular product	10	27	18	27

Source: SEO/TNS Nipo 2010

This picture is consistent with findings made by TNS Nipo in research into the effectiveness of the Financial Information Leaflet: "A high level of awareness does not mean that everyone will actually use a Financial Information Leaflet when pursueing a complex financial product. In practice, two out of five consumers from the target group consulted a Financial Information Leaflet when confronted with such a decision. It did not occur to the others to look for the Financial Information Leaflet, and/or they assumed that they could trust their adviser sufficiently".[31]

The intermediaries in the study put this picture into sharper focus. Only 2% indicate that the information from the services statement has a major influence on customers' preferences for a par-

31 R. van Steen, J. Visser, A. Eecen (2009), *De effectiviteit van de Financiële Bijsluiter* [The effectiveness of the Financial Information Leaflet], Amsterdam: TNS Nipo.

ticular product; 15% rates it as having a limited effect. The remaining 84% does not see any correlation between information in the services statement and the choice for a product.

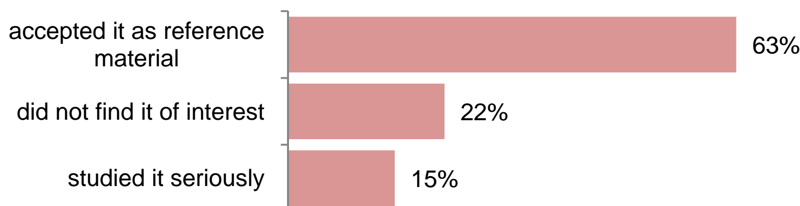
There were two exceptions:
- customers who decided to purchase from a direct writer report in somewhat larger numbers that they have been (partly) guided by information about the cost of the product;
- customers who took out life insurance that was not linked to a mortgage, examined the price of the product more closely.

In both instances, the customer's freedom of choice is more restricted in advance than in the case of an entirely open mortgage loan transaction, with several providers and several products at stake. There is less information and thus also less information overload.

A lukewarm response on the part of consumers to remuneration-based information also emerges from a survey conducted with intermediaries in 2009 (SEO/Assurantiemagazine 2009). The information is taken for granted, see Figure 4-5.

One of the interviewees notes that there hardly is a culture of negotiating prices or haggling in the Netherlands. The Dutch are more likely to express their dissatisfaction with a supplier by walking away ('exit') than by negotiating ('voice'). The respondents on the consumer panel confirm this. A small minority of the customers (10% of customers in the intermediary channel; 20% of customers in the direct writing channel) report having negotiated the height of the remuneration in response to the services statement (and/or the qualitative statement of costs). A considerable number of these, especially in the direct writing group, also said they would have negotiated without either of the documents.

Figure 4-5: Reaction in response to the information on remuneration



Source: SEO/Assurantiemagazine 2009

These low numbers correspond with the intermediaries' perception. While 60% report that their remuneration is more often the subject of discussion with customers than it was in the past, this does not mean that those discussions actually ended in negotiations about price.

Impact of transparency: price perceptions

The consequence is that only 30% of the consumers who took out a mortgage and/or life insurance over the 18 months, report to be aware of the remuneration received by their intermediary. More than a quarter indicated that while they do not know it, they know where to find the information. 43% of those who recently purchased a complex product, do not know what the remuneration of the intermediary was.

The Financial Services Ombudsman notes that if it more explicitly shown to consumers that they (have to) pay (directly or indirectly) for their intermediary's services, the the number of complaints about the costs rises. Thus information about remuneration results at first not so much in pressure on prices, but rather in complaints – which are inadmissible, because the Ombudsman does not make pronouncements about the level of remuneration. The latter is confirmed in the other interviews. In the perception of consumers, they have never paid for the intermediary's services in the past. Now that this has been clarified thanks to cost transparency, the increase in the number of complaints makes it clear that they are not prepared to take these costs for granted.

The fact that customers cannot discern whether an intermediary is putting their interests first, or whether he is being governed instead by incentives relating to his own gain, is one of the most important expressions of information asymmetry in the insurance market. It would seem from consumers that the services statement has not removed this gap. Three-quarters of consumers report not being able to assess the extent to which the intermediary with whom they have done business would be remunerated in various ways for the various products from the various providers who might have been at stake. Only 8% indicated they had a good understanding of this. It should be said that this does not mean that the services statement fails to make this information transparent. If consumers hold the position that the remuneration between intermediary and provider does not affect them, they will simply pay little attention to the matter. This conclusion also emerges from the interviews: consumers have little interest in the remuneration flows between intermediary and provider, until it is ecplictily clarified to them that it is they who will have to pay for the advice.

Conclusion: *For the present, the impact of the services statement and qualitative statement of costs on consumers' decision-making is very limited. Only for a minority of consumers, the information concerned is a decisive or supporting factor in the decision-making process, when choosing a distribution channel, an intermediary or a specific product. There are there no indicators of consumers being inclined to shop around more.*

4.4 Balancing rule

The balancing rule maximises the brokerage commission at fifty percent of total remuneration for the intermediary.[32] *The remainder of the remuneration must be paid gradually over a ten-year period. The objective of the regulation concerned is to foster a sustained relationship between intermediary and consumer: the intermediary remains dependent for his turnover on a block policy over a period of ten years and, therefore, it is assumed it is to his advantage to be customer-oriented during that period. In addition, it is intended to reduce a practice of 'hit-and-run' advisece, concentrating on securing quick profits.*

The shift from brokerage commission to renewal commission

Implementation of the balancing rule takes place between insurers and intermediaries. It has been introduces seamless. For firms with the Dutch Insurance Brokers' Association (NVA), the ratio of brokerage commission to renewal commission used to be 2:1 (Table 4.8). This ratio was changed in 2007 to virtually fifty-fifty. This accelerated move to the maximum brokerage com-

32 Between 2007 and 2010, the maximum percentage of brokerage was reduced in 10% increments from 90 to 50%.

mission (50%) can be traced back in part to the costs of software adaptation. It is (evidently) more economical to adapt systems in one go than to do so in stages each year. 2007 saw growth in the share of bonuses in intermediaries' sales.[33] Data from the broker's firms in the StFDdatabase, which encompasses a significantly larger population of firms, shows a comparable trend, albeit with a greater share of bonuses, a share that declined again after 2006. There is no data (yet) available for 2009, but a further continuation of the commission ratios with bonuses receding is generally anticipated. Only a very small part of turnover can be accounted for through other mechanisms, such as (hourly fees and subscriptions.

In 2008, the ratio for mortgages was still very different (source: StFD). 73% of turnover in that case came from brokerage commission, 17% from renewal commission, 9% from bonuses, 1.5% from hourly fees and 1% from remuneration based on some other principle (fixed fee: a fee per transaction). There are signs, although still no hard evidence, that a shift has been taking place in the mortgage market recently towards direct forms of remuneration.[34]

Table 4.8: Structure of turnover for life policies

	NVA 2003	NVA 2004	NVA 2005	NVA 2006	NVA 2007	StFD 2006	StFD 2007
Brokerage commission	65%	65%	64%	64%	48%	60%	55%
Renewal commission	35%	33%	33%	34%	47%	30%	36%
Bonuses	<1%	<2%	<3%	<2%	5%	9%	7%
Hourly fees			-	-	1%	1.5%	0.7%
Other							0.3%

Source: Business comparison studies (NVA 2003-2007; SA StFD 2009)

A more sustained relationship between adviser/intermediary and consumer

The balancing rule, supplemented by the commission refunding rule, aspires to promote a sustained relationship between the adviser/intermediary and the customer. The intention is for this to produce lasting relationships.[35]

The interviewees agree that the balancing rule has prompted a withdrawal from the market of those 'commission hunters' whose 'hit-and-run' practices were strongly emphasised during the period 1995-2005.[36] Because of that, they view this instrument as successfull. The question remains whether the instrument has also led to a more sustained relationship between intermediar-

[33] It should be noted further to this that the manner in which surveys were taken was changed in that year, better portraying bonuses for life policies as a result. Players are under the impression that the increase in bonuses was a response to the reduction in brokerage commission. That response was soon reversed thanks to the ban on bonuses.

[34] Managing director Ron Bavelaar of *De Hypotheekshop* (a franchise chain) mentions that "more than half our advices are charged on a billing basis". (*Assurantiemagazine* 16, 3 September 2010, page 32.)

[35] The regulations are so recent in nature that it is not yet the ideal time for identifying any sustained effects.

[36] This entails a question of causality. The period 1995-2000 was one of strong economic growth that saw a boom in the housing market with all manner of investments becoming popular among broad swathes of the population. It was a time when many gains were to be made by 'commission hunters'. Not only have the regulations changed since then, but the market has also become much less amenable to hit-and-run practices.

ies and consumers in the regular area of the market – and to advisers who take a more enduring approach to working on their customers' behalf. The contractual relationship between intermediary and customer used to be a sustained one. The customers of insurance brokers are notorious for their lack of mobility. In the period 2005-2006, the degree of inflow and outflow of insurance firms' life policy customers was between 3 and 5%. That is a level of retention on which it is difficult to improve.[37] Intermediaries in the present study indicate no evidence of change in the amount of outflow.

A sustained relationship does not necessarily mean that intermediaries will exert themselves on behalf of all the customers in their portfolio. The interviews show that intermediaries are still searching in the implementation of an active relationship throughout the course of a policy. Ideas about a periodic (annual or biennial) inventory of any relevant events – an amended risk or prosperity profile for all the customers in a portfolio – appear to come largely from external sources: industry associations and advisers who indicate the importance of such a periodic update.

At the same time, providers and intermediaries point out that there are products which do not require follow-ups, such as straightforward single premium policies. The policy is taken out for a particular term and ultimately results in a payment. The policyholder (or his hiers) reports any relevant events if they arise in the maturity. If such is not the case, there is no reason for contact. Various parties ad that the balancing rule and the inducement standard conflict with such products. The balancing rule takes the premise of a ten-year renewal commission; the inducement standard states that remuneration (including the renewal commission) should be as much as possible in line with the efforts made on the customer's behalf throughout the maturity. The market considers the balancing rule to be 'harder' than the inducement standard. This is in part due to the balancing rule's simplicity and unambiguous interpretation.[38]

The number of instances of commission refunds owing to premature termination of the policy has remained limited up until now. However, the situation is still too recent to enable proper assessment of the extent to which this will arise. It is also unclear whether the market has built in effective mechanisms to ensure that the fee, which has been or is to be refunded, ends up with the customer.

Box 4.3: Transfer costs

One of the commission policy's objectives is to make consumers more mobile. There should be no spurious obstacles standing in the way of a consumer's wish to switch insurer or adviser. In the absence of a benchmark, it is impossible to say whether this situation has proved. In the consumer module in this study we asked whether people had recently switched intermediaries and/or insurers (i.e. whether they also switched products). A disproportionately large number of consumers in the study answered that they had done so. After all, they had been selected because of having recently taken out a mortgage and/or life insurance policy, thus the panel inherently contained many switchers. The results indicate that switching intermediary is a relatively hurdle-free

[37] SEO Economic Research, *Bedrijfsvergelijkend onderzoek assurantiekantoren 2005, 2006* [Business comparison study of insurance firms 2005, 2006] (Amsterdam: 2006, 2007)

[38] According to one of the interviewees, the AFM supposedly indicated that the inducement rule took precedence over the balancing rule. This was not taken up by the sector out of a fear that punishment would be exacted nevertheless for any non-compliance with the balancing rule.

process, but that changing to a different provider does not go without problems.

Table 4.9: Obstacles when transferring?

	Changed intermediary	Changed provider
Laborious	7	24
Required effort	16	33
Straightforward	77	32

Source: SEO/TNS Nipo 2010

Spreading the costs of a product over its term

Bringing brokerage commissions and renewal commissions into balance has scarcely had noticeable consequences for consumers. As a rule, the total commission sum is settled at the time of the financial transaction itself and either deducted from the premium to be deposited or co-financed, such as in the form of a single premium policy.[39]

A spread fee does not necessarily mean greater congruence between effort and turnover for the intermediary either. Effort peaks around the time of purchase and around the time of terminating the policy. As observed previously, there is still no unambiguous *modus operandi* in the market for maintaining relationships throughout the term of the policy.

A side effect observed from various quarters is that of high administrative charges. Renewal commission (paid in advance by consumers) is paid by insurers to the intermediaries in the form of 120 monthly instalments, all of which – according to the intermediaries – must be entered and verified.

Conclusion: *the sector has responded to the balancing rule 'according to the letter of the law'. In the life insurance segment, at any event, the rule has resulted in a thorough change to the ratio of renewal commission to brokerage commission. An exodus of 'commission hunters' is signalled as evidence of its success. This does not necessarily mean that the balancing rule has also led to the envisaged change in conduct among intermediaries, in the sense that they will now show more enduring concern about their customers' interests. The sector is still finding its way in that regard. There is simultaneously resistance against the rule, because it makes little differentiation in terms of product type and, consequently, in terms of the actual level of intensity that any aftercare might require. In some situations the balancing rule conflicts with the inducement rule.*

4.5 Inducement

The idea underlying 'appropriate commission' is that the type of remuneration should encourage the adviser/intermediary to act in the consumer's interest.[40] *After all, 'perverse' forms of remuneration, such as volume-*

39 One of the respondents noted that mortgage customers particularly appreciated tax deduction facilities. The fact that the commission can be financed and that the cost of cash loans connected with mortgage loans (such as commission) is tax deductible goes some way towards explaining why the intermediary's remuneration is not a factor of overriding significance for consumers.

40 The hybrid nature of the word 'commission' is troublesome. The legislature and the outside world use the word in an elastic manner: 'the intermediary's remuneration, whatever form it takes'. Players in the sector have been inclined to give the word a precise interpretation: 'the sum produced as the product of com-

related bonuses, can direct the adviser/intermediary to providers and/or products that have not been optimally tailored to the demands and situation of the consumer in question. An important expression of the inducement standard is the ban on turnover-related bonuses.

Limited shift from commission to other forms of remuneration

The AFM has repeatedly stipulated its goal for a remuneration system in which the intermediary, instead of by means of commission, is paid on the basis of the costs plus margin for his efforts.[41] As stated above, when analysing the composition of the turnover of advisers and intermediaries, there has been only a very minor shift from commission to other forms of remuneration, such as hourly fees and subscriptions, i.e. from brokerage fees to (indirectly, via the providers) to direct remuneration by the customer. In 2008 within the life insurance package, only 4% of intermediaries' total turnover consisted of forms of remuneration other than brokerage commission and renewal commission.

Market experience shows that the introduction of direct remuneration is not straightforward. Research commissioned by the *Association of British Insurers* indicates that consumers are less than enthusiastic about paying for an adviser without knowing clearly in advance the direction that the advice is taking – e.g. being advised *not* to take out a particular policy.[42] The paradoxical situation arises that consumers who are indifferent about commission sums they cannot (or do not wish to) see, are not prepared to agree to a direct payment. However, one of the interviewees (from the intermediary industry) notes that 'consumer's full interest is awakened' once the rationale underpinning direct payment is explained ('preventing the intermediary from being governed by the provider's remuneration').

Nevertheless, the picture also emerges from the interviews that firms wishing to declare their services to the customer on the basis of direct payment have difficulty in agreeing on a 'reasonable' hourly rate. TNS Nipo reports that, on average, mortgage customers feel an hourly rate of € 57 (gross) to be reasonable, while mortgage advisers themselves operate gross hourly rates of between € 95 and € 145.[43]

In 2010, two-thirds of the firms said that the share of commission within their firm's turnover had fallen since the introduction of the Wft and Bgfo. In contrast, there had been a rise in the same order of magnitude (i.e. in terms of the number of firms and not in terms of turnover) concerning the share of hourly fees. There was scarcely any incidence of subscriptions as the basis for a remuneration system. The most important actual shift in the market is the disappearing of bonuses. The value of bonuses, such as were being paid up to and including 2008, remains in the

mission rate plus premium'. This can result in conceptual confusion with regard to a concept such as 'appropriate commission'.

41 See for example 'AFM wil deksel op strooppot' [AFM wants lid back on jam jar]. Interview with AFM managing director Kockelkoren, *Assurantiemagazine* 2009(10), pages 8-10.

42 Association of British Insurers (2009), *Adviser charging in the Protection Market – Strictly Financial*, ABI Research Paper.

43 TNS Nipo, press release dated 18 August 2010, further to *Onderzoek provisiebeleving consumenten* [Study on consumers' experience of commission]. NB This study is separate from the surveys that TNS Nipo has conducted for the purposes of this evaluation study.

supply chain. It remains to be seen whether this value will be passed on to the consumer in the form of lower prices.[44]

Box 4.4: Remuneration in kind as of 2006

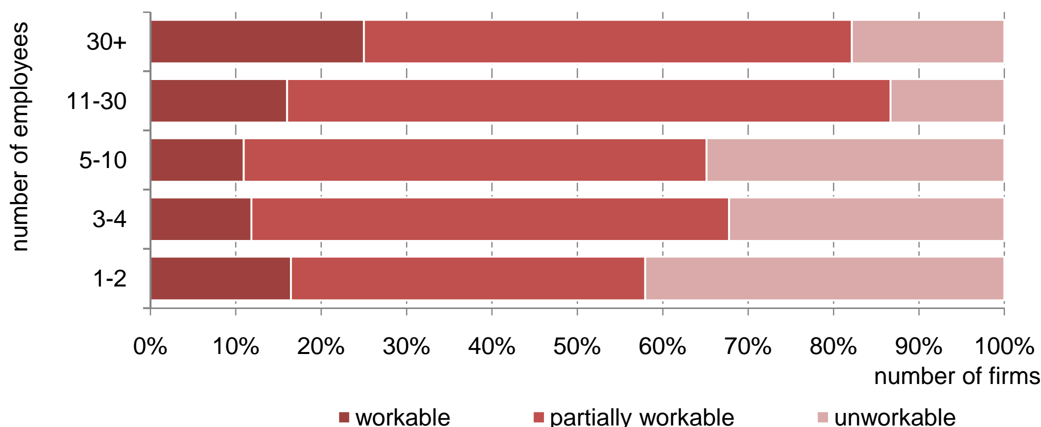
The 2006 self-assessment of the StFD showed that, in 2006, 12% of the firms enjoyed remuneration in kind from providers, rising from 5% (of the number of firms) among the smallest firms to 25% among the large firms. Participation in training courses and attendance of conferences form the greater part of this type of remuneration. The multiple possibilities for interpreting the term 'commission' as cited above are part of the reason for this.

Feasibility of other forms of remuneration

14% of the firms regards a remuneration structure founded on hour-based statements to be a feasable alternative Half of them calls it 'partially' workable. Larger firms are more positive about a system of hourly fees than small firms (Figure 4-6), with the line between large and small being drawn at approximately ten employees. As a rule, large firms have more business customers, for whom they are used issuing hour-based statements (at least partly).

Attitudes about a subscription system are generally more sceptical (Figure 4-7), even if the idea is not rejected industry-wide. Here, too, it is the larger firms that are more positive, possibly prompted by experiences within the SME market.

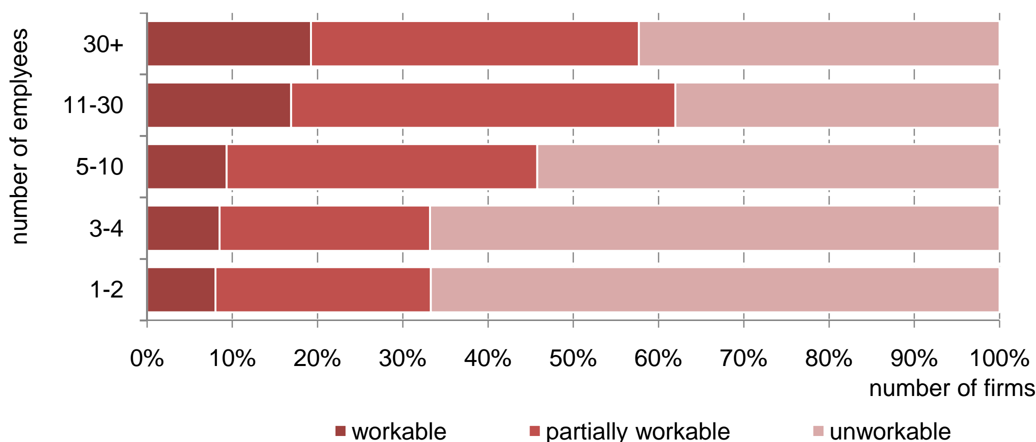
Figure 4-6: Hourly rate as a workable alternative for remuneration



Source: SEO/TNS Nipo 2010

44 Moneyview (*Special Item Overlijdensrisicoverzerkeringen* [Special Item Term Insurance], August 2010) sees a decrease in supply in the life insurance market. However, supply is expanding in the term insurance product group. Moneyview observes an increasing degree of commission flexibility for this product group, i.e. a choice between commission and hour rates.

Figure 4-7: Scepticism about the subscription system



Source: SEO/TNS Nipo 2010

Approximately the same proportions between 'feasible' and 'not feasible' in a survey on the feasibility of remuneration systems conducted in the first half of 2009 (SEO/*Assurantiemagazine*, 2009). The conclusion is that, although other forms of remuneration are under consideration, they are as yet enjoying very limited receptivity in the market.

Do advisers focus more on the interests of the customer?

As indicated in the effects of the balancing rule, some of the market's hit-and-run mentality has disappeared along with the 'commission hunters'. According to various market players, this has solved most of the problems. The question remaining is the degree to which regular players are (still) being governed by improper financial incentives, e.g. through leading consumers to providers or products, resulting in greater remuneration for the intermediary.

Of the consumers surveyed for this study, 80% indicate they are not under the impression that the intermediary concerned was being driven by differences in remuneration between providers.[45] 20% did have that impression. Of those 20%, more than half raised the matter with the intermediary.

Customers show more reliance in the degree to which they are able to assess whether the intermediary puts their interests as consumers first: 36% indicate they are well able to make that assessment; 29% have some perspective on the matter. Of those who expressed an opinion, 83% trusted their own intermediary to have put consumer interests wholly first, while 15% felt that this was 'partially' the case.[46] Only 2% felt that the intermediary concerned had not proceeded in the interests of the consumer. The intermediary channel is rated better than the direct writing channel in this respect.

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[45] This pertains conditionally to those customers who expressed being well informed or partially informed on the matter – i.e. a minority within the total.

[46] It is a well known in financial psychology that consumers dislike admitting they have made the wrong choice – not even if that is placed in a reasonably anonymous setting. Consequently, this degree of contentment with the intermediary is probably an overestimate or, at least, at the upper limit.

Box 4.5: Inducement within the firms

Volume-related remuneration does not occur only between providers and intermediaries but also within the intermediaries' firms. A situation in which employees (both commercial and clerical staff) can be eligible for turnover-related bonuses is not uncommon practice in the industry. Although such remuneration schemes need not to result in a provider or product bias, it certainly can lead to a sales-driven culture, in which recommendations not to carry out a transaction or not to acquire a product at all, are less likely to be made.

There is a stated decline in the number of firms paying their staff, or a subset thereof, in this manner. 14% of the firms in the study said that remuneration dependent on sales existed as of 2010. In 2005 that figure was 23%.

Sincere advisers should be able to recommend their customers not to perform certain transactions or not to enter into certain commitments. 22% of the intermediaries in the study said that they now more commonly advise not choosing a particular type of product, than it was the case prior to the introduction of the regulations. This is a step in the right direction in putting the customer's interests first. However, varius respondents indicate that the explicit question whether a mortgage loan is divorce-proof (and/or establishing that a mortgage loan is not) is still taboo territory among both advisers and consumers. Consumers see their mortgage adviser as someone who should arrange the mortgage, but not as an advisirin making important decisions. Advisers who tell consumers 'no' in such a situation, assume that the customer will always find a competitor who will *not* advance any critical questions and who *will* actually sell them the mortgage.

The interviews have thrown up quite a few critical observations about the regulations, the regulator and the market parties – as well as about the consumers. Even so, there is also a widely held feeling that the regulations have turned out well on balance, in part because the 'commission hunters' have gone from the market and also in part because the parties have been compelled to reflect on their position and feel impelled to clarify their added value. There is a shared belief that the quality of advice has improved in recent years and, as a consequence, the products sold are now also more appropriate and more appropriately priced.

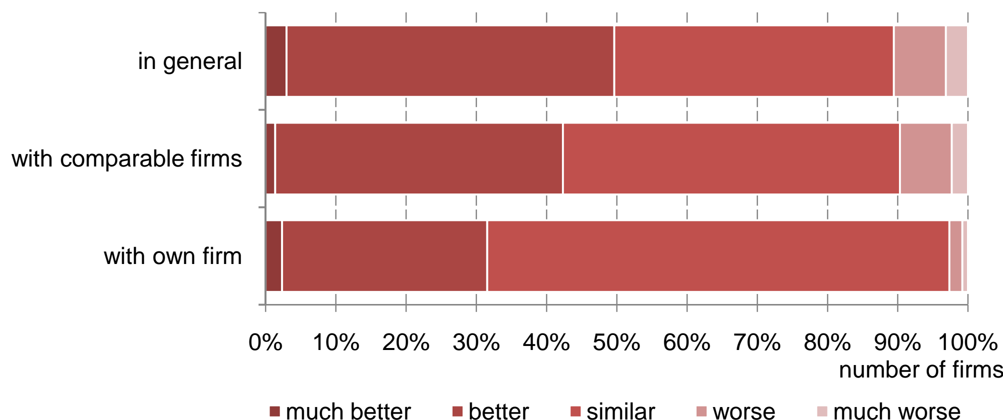
Customers' limited insight into the financial product itself, the services provided and the attached costs does not result in a sense of being taken for a ride. 11% of consumers in the study sais they are unable to assess whether the mortgage (or life insurance) properly suited their financial situation and risk profile. Of those who could or believed themselves able to assess this, 85% judge the financial product to suit them completely or almost completely.[47]

The intermediaries in the survey were asked whether the quality of advice has improved since the introduction of the commission regulations and whether more appropriate products are being sold. In order to avoid and/or neutralise futile or evasive answers, , the question was split into a three-way division: 'in the market' (risking trivial answers – when substandard firms exit the market, average level always improves), with 'your own firm' (risking evasive answers) and 'with

[47] It should be noted in this regard that the consumers surveyed had all recently taken out or renegotiated financial products or else had insured them elsewhere. The amount of time to have elapsed in respect of the term for these products has been so short in duration that, for the majority, it has not yet been possible to prove the products' shock resistance or that of the advice given.

comparable firms'. The last option was expected to be the most informative and, in the end, also refers to the respondent's own firm.

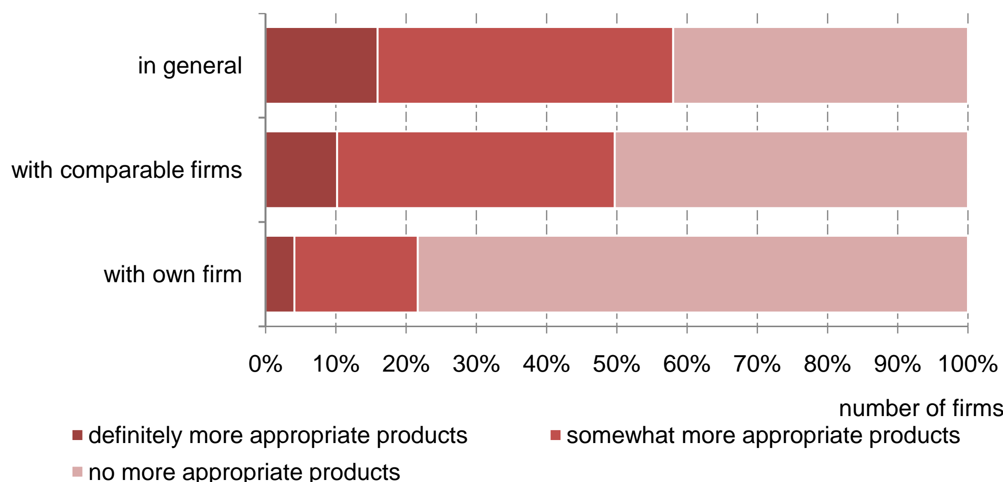
Figure 4-8: Quality of advice largely better with 'the others'



Source: SEO/TNS Nipo 2010

Despite all the criticism among intermediaries about the regulations, a surprisingly large number of them indicate that the quality of advice has improved, with their own firms, with comparable firms and in the market in general (Figure 4-8). 43% of the firms seean improvement with comparable firms set against 10% who seen a worsening. A remarkable 32% indicates that the quality of their own advice has improved as well, thereby implicitly admitting that there was room for improvement.

Figure 4-9: More appropriate products sold – especially by 'the others'



Source: SEO/TNS Nipo 2010

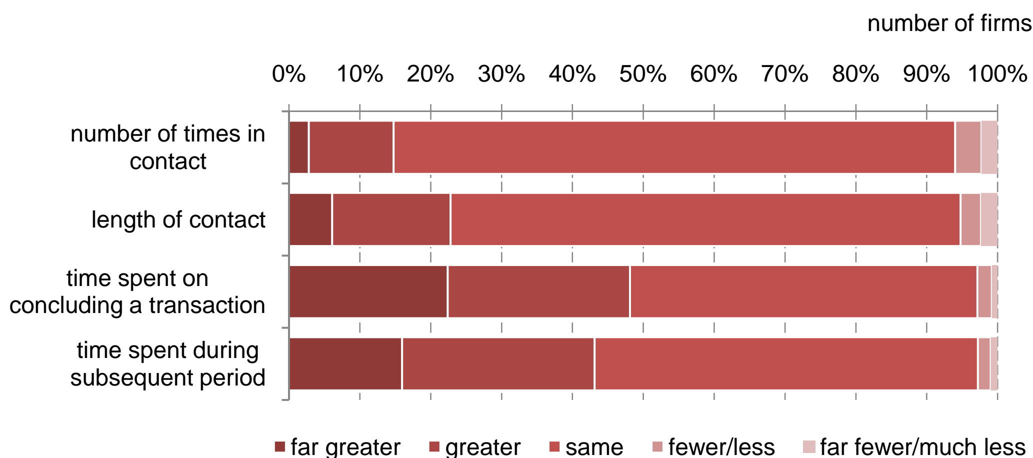
The question of whether more appropriate products are being sold now, results in answers comparable with those for the quality of advice (Figure 4-9). Half the intermediaries in the study feels that comparable firms are selling more appropriate products across the counter. 22% indicated that this is also the case at their own firm.

Complaints

A change in the number of complaints about services can be an indicator of the quality level having changed and also of a more critical attitude among consumers. The intermediaries surveyed in the study do not report an increase or decrease in the number of complaints about services or about the level of remuneration.[48]

The Financial Services Complaints Body (KiFiD) reports a considerable increase in the number of complaints for the years 2008 and 2009. It attributes this in part to the recession in which "the shortcomings of financial services clearly come to light."[49] "It is then that consumers also become more critical about their purchases, albeit passing a judgment after the event on whether what the purchases have delivered, i.e. the result, has lived up to their expectations." The new complaints stem from the advisory and intermediation practice of foregone years and thus say little about a change in the quality of advice as of 2008 and 2009. Insofar as this increase points to a more critical attitude on the part of the consumer, this is a step in the right direction in light of the policy on transparency and commissions. Apart from that, the Ombudsman remarks that many complaints relate to the amount of the intermediary's fees, an aspect that falls outside of the Ombudsman's remit. Such complaints may have more to do with the realisation that payment has to be made for the intermediary's services than it does with the amount of his fees.

Figure 4-10: Increasing burden per customer/policy, largely administrative



Source: SEO/TNS Nipo 2010

Efforts made and the adviser/intermediary's remuneration

Apart from the disappearance of turnover-related bonuses, the remuneration remains largely based on commission. Thus remuneration for intermediaries is still tied to the amount of the mortgage loan and/or life insurance premium, and not to the intermediary's efforts on behalf of the customer.

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[48] 56% of the firms remarked that they had never yet received a complaint.

[49] KiFiD, *Jaarverslag 2009* [2009 Annual Report], The number of different providers and intermediaries to which the complaints relate is unknown.

It emerges from the intermediaries in the survey that the amount of time they devote to their customers is actually increasing (see Figure 4-10). This applies to the number of contact moments and to the total length of time spent with the customer (front office), but especially to time spent by the administrative employees, the back office. The difference between the increases for the front office and back office is an indicator that the firms are more strongly inclined to associate the commission regulations with a process of administrative burden than with a process in which customers care is enhanced. The conclusion further to Figure 4-10 must be that, all things being equal, the intermediary's costs per policy (and/or per customer file) are rising.

Wider choice

Turnover-related bonuses used to give the intermediary an incentive to lodge many customers with the same insurer (s), without considering whether those insurers truly had appropriate products in their range for the customers concerned. The disappearance of these bonuses could prompt intermediaries to cast their nets more widely in supply-related terms and to enter into business relationships with more insurers. If the range from which to choose is larger, and if there is sufficient diversity, this mechanism should result on average in a better match between customer and product.

Box 4.6: Position of service organisations

Service organisations (service providers) serve multiple functions:

- They generate purchasing power (*countervailing power*) on the part of intermediaries. By combining product purchase they create scale, which is (was) converted into favourable purchase prices. Instead of a discount agreed in advance, the settlement system for this had long been the payment of bonus commission, rising according to the volume attained. This bonus commission accrued in part to the service organisations themselves and in part to the affiliated firms. The sum returned to consumers in the form of return commission (legally permissible in 2002) was limited.[50]

- The *financial supermarket*. Intermediaries affiliated to a central brokerage agency or purchasing consortium can take out policies through this collective channel with insurers with which they have no service agreement. The service providers cover a wider range of insurers and products.
- The various franchise chains in the mortgage market also provide a market profile to their affiliated firms. They are responsible for collective marketing and supply collective back office services. These chains also play an important role re their members' culture of compliance. They interpret the regulations for their affiliated firms and provide them with protocols that cohere with the Wft and Bgfo. In part, the chains also act as pioneers in the introduction of new remuneration systems.

The gain in transaction costs, on the basis of which service organisations were able to act like fi-

[50] According to benchmark studies held among Dutch Insurance Brokers' Association firms, approximately 60% of the firms paid return commission to customers in the period 2005-2006 amounting to between 0.5 and 1% of total commission turnover (SEO Economic Research, *Bedrijfsvergelijkend onderzoek assurantiekantoren 2005, 2006*, Amsterdam: 2006, 2007).

nancial supermarkets, has by and large faded away due to developments in information and communications technology. Service organisations have been partly superseded by the internet, and thus their added value has diminished.

Through the ending of opportunities to collect bonuses, service providers lose a significant portion of their revenue. To keep operating, they need either to acquire another type of remuneration from insurers (although this may run foul of the inducement standard) or increase the financial contribution made by its member firms, which must either bear the cost themselves or else pass it on to their customers. The market leaves hardly room for the latter option. This results in a waning in the importance of service providers. A consequence of this is that intermediaries are once again relying more on insurers with whom they have service agreements. This reinforces the aforementioned shrinkage of supply further.

The balancing rule runs up against the inducement standard for service providers who merely play the role of go-between respecting intermediaries and providers. After all, service providers are involved in the transaction only at the time of its conclusion, and play no part in the follow-up process. Consequently, a spread out commission payment (balancing rule) conflicts with the aim to make efforts on behalf of the consumer and remuneration congruent (inducement).

The effect of a wider range of choice is not present. On balance, the number of preferential insurers with which intermediaries work is no different in 2010 from the situation in 2005. 10% of the firms indicated that they had started working with other insurers. For the largest firms (more than 30 employees – there are not very many of them), there has even been a slight increase in the number of preferential insurers. In 2010, the share of turnover the intermediaries in the study obtain from their preferential insurers is larger than in 2005. Thus there is concentration rather than differentiation in the number of insurers with whom intermediaries work. Consumer choice has in fact been curtailed as a result.[51]

A comparable process takes places with 'objective analysis', where the adviser makes his recommendations without being contractually bound to insurers (Wft, Section 4:72). Most firms (94%) indicate that they use objective analysis, but the number of products under consideration on average is limited (between three to five is the norm). It emerges from the interviews that the information costs for objective analyses are felt to be too high and that objective analysis in practice does not in fact exist'.

Conclusion*: The inducement rule has removed the most significant perverse incentive from the system: the turnover-related bonus. Virtually all parties agree that the quality of advice has improved in recent years and that more appropriate products are being sold. For a variety of reasons, there has been a narrowing of supply rather than a broadening. Intermediaries carry products from fewer insurers providers than before. A shift to forms of remuneration other than commission is slowly getting underway. At present, consumers are unwilling to pay directly for advisory and intermediation services. For many advisers and intermediaries there is correspondingly little enthusiasm about rousing consumers' interest in this.*

[51] Another reason given for this is a fall over recent years in the number of insurance companies in the Netherlands.

4.6 Evasive behaviour

Paragraph 4.1 outlined the image of a conservative sector that is inclined to to seek out opportunities for evasive behaviour, in order to carry on as far as possible with former practices. In an evaluation study such as this, it is difficult to put such practices under scrutiny. It is virtually impossible to determine the scale on which this may occur. Nevertheless, various sources have mentioned mechanisms.

The waterbed effect

Insurers Providers may no longer furnish any volume-related commission for complex products, either in the form of bonuses or in kind, such as support in the shape of education (e.g. linked to travel) or the secondment of personnel. There are no indications that direct volume-related forms of remuneration still occur in the complex products channel. However, there are indications of a shift from such forms of remuneration to other segments. This shift is referred to as the *waterbed effect*. Firms achieving volume in life insurance policies and/or mortgage loans would receive additional payment through the service agreement relationships these firms have for non-life insurance with the same companies.

Turnover quota

It is noted from various quarters that although insurers no longer have any bonuses to drive production, they still they employ turnover quotas: a threshold that has to be reached in order to maintain the service agreement. As long as intermediaries have not completed their annual quota for the insurer concerned, there remains an incentive towards this insurer. This hinders the impact of the inducement rules.

Another factor that can stand in the way of independent advice is the existence of financial flows and commitments between insurers and intermediaries other than commission streams alone. Insurers are also involved as investors or financial backers for intermediary firms, e.g. in order to finance transferred portfolios. This financing is often accompanied with turnover agreements, whether explicitly or otherwise. Although the practice of this type of finance is diminishing, it does still exist – current contracts and agreements do not simply disappear.

Payments by the provider

One of the ways in which information asymmetry occurs, is obscurity about the services that intermediaries perform on behalf of the consumer and those he performs on behalf of the provider. A method mentioned several times for getting round the inducement standard, is to split the intermediary's remuneration into a commission component (charged to the consumer under the inducement rules) and a payment for work on behalf of the provider (outside the inducement rules). The provider can recover the costs through surcharges on premiums and interest. On the one hand, a split between services performed for the consumer and services on behalf of the provider can be seen as an execution of service transparency. However, service transparency without cost transparency is incomplete.

A comparable method for evading the inducement rules, also cited many times in the interviews, is the use of the underwriting agency channel. Portfolios are moved from the traditional intermediary to the underwriting agency channel. In this channel, part of the remuneration for the un-

derwriting agent consists of underwriting commission, which is viewed as payment for services provided to the insurer, i.e. a form of remuneration that falls outside of the inducement rules.

Excessive fees

The AFM has observed that situations are arising in relation to unemployment payment-protection policies in which advisers are not being paid on a commission basis (within the inducement rules) but on a fee basis, charging 'excessive' amounts in that regard.[52] The customers are notified in advance about payment obligations and have to sign them. It is only later that they are confronted with (extremely) high statements for services or advice that had not been explained clearly beforehand. This is a case of incomplete transparency. After all, the market shows that advisers in receipt of regular, direct fee-based remuneration "have great difficulty in getting a 'reasonable' hourly rate accepted" and thus that customers will not voluntarily accept in advance very high statements.

***Conclusion**: There exist diverse forms of evasive behaviour, but they are hard to prove. It is difficult to get to the bottom of this practice. Market players observe that it will occur on a limited scale for as long as these mechanisms continue to exist.*

[52] Letter from the AFM to the Ministry of Finance dated 9 September 2010.

5 Consequences for the market

It is not only the position of consumers that is affected by the regulations. A sizeable component of the regulations intervenes in the relationship between providers and intermediaries. This has resulted in shifting the role and place of intermediaries and their business practice.

5.1 Intermediaries' business practice

Intermediaries' turnover and profits are being put under pressure. Two-thirds of firms in the study indicate that, as of 2010, the average remuneration per policy and/or concluded mortgage loan is lower or considerably lower than it was in 2005. While this has partly to do with the commission regulations, it is chiefly because of the housing market crisis.

The discontinuation of bonus commission has also resulted in financial problems, albeit to a lesser extent: 10% said that the firm's continuation was at stake, while 22% felt that the problems, although considerable, did not pose a threat to their continuity.

The shift from brokerage commission to renewal provision has resulted in a (temporary) liquidity problem among intermediaries. 43% of firms indicated that the financial consequences for the firm had been severe, 18% even mentioning a danger to the firm's continuity. The numbers involved depended on the size of the firm.

There has always been a strong financial interconnection between insurers and intermediaries. Most intermediaries no longer collect premiums and thus are dependent on insurers for their flow of turnover and operating capital. To that end, intermediaries maintain a current account with insurers. This enables them to cushion temporary liquidity problems through an overdraft facility. It is that facility which makes intermediaries dependent on insurers and which can result in false loyalties.

A large number of the interviewees indicated that the balancing rule had reinforced this dependence. Many of the intermediaries approached their providers in order to cushion their liquidity problems. At the same time, it was observed on the part of the insurers that there is now less readiness than there was a few years ago to keep intermediaries who are in financial distress afloat.

Remarkably enough, virtually none of the firms in the Netherlands StFD Self-Assessment for 2008 (produced in 2009) admitted to liquidity problems, while 14% of the firms reported that they lacked positive equity – meaning that they were insolvent and thus, technically, bankrupt. Nevertheless, these firms were not anticipating the termination of business activities, implying that their heads were being kept above water through externally supplied operating capital. This was usually from providers with whom the intermediaries concerned held a current account. This is at odds with statements from insurers that they are less inclined to support financially distressed intermediaries.

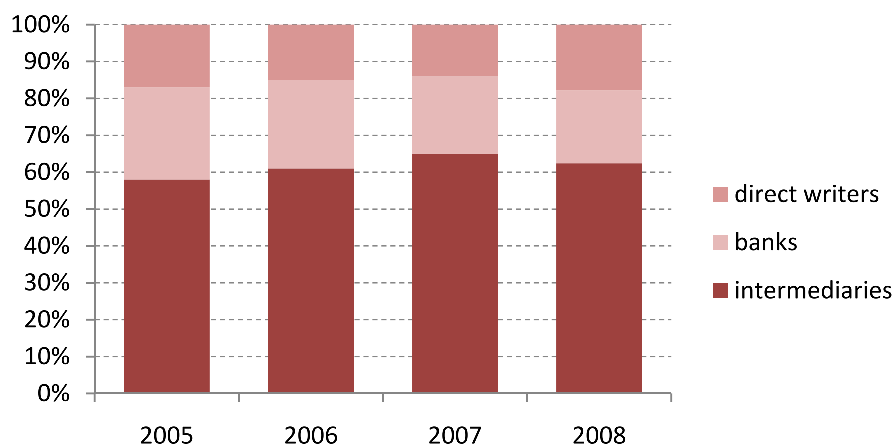
5.2 Level playing field distribution channels

Something often heard at the time of introducing the regulations was that there had been tampering with level playing field between the intermediary channel (mostly insurers) and the direct writing channel (banks and some insurers). Greater demands were to be placed on the intermediaries, which would lead to higher administrative charges and, consequently, to a competitive imbalance favouring the direct writing channel. However, this complaint (or observation) receives only sporadic material support in the interviews. In the end, the conclusion reached was that added value was chiefly at issue – and displaying that added value.

An uneven playing field cannot be directly perceived in shifts between the distribution channels as far as the taking out of new individual life policies is concerned. The market share of the intermediary channel (Figure 5-1) fluctuated around 60% since 2005. Market share for the direct writing channel (including salaried agents) fluctuated rather more markedly at around 16%. Only in the case of the banks has the picture been unvarying in its gentle downward progression.

A stable balance between the distribution channels does not necessarily mean that the level playing has not been disrupted. Compensation mechanisms can appear via other sectors, such as non-life. No indications of this have been identified.

Figure 5-1: No (major) shift in distribution channels regarding new individual life policies



Source: CVS

5.3 Level playing field within the intermediary channel

A point advanced from various sides is that the transparency and commission rules work unequally for different types of players in the intermediary channel.

By and large, compliance costs are felt to be high. This is owed in part to regulations felt to be fragmentary and frequently unclear in their wording. According to one of the respondents “a considerable amount needs to be done in order to comply with all of the requirements; it looks

increasingly as if an AFM-proof customer file does not and cannot exist." Since some of the efforts made for compliance are fixed in character (even if it is just a question of familiarisation with the new regulations), this strikes the minor players as disproportionate.[53]

The AFM is said to focus its controls too much on the visible part of the market, i.e. the larger businesses and chains. Given the AFM's limited capacity, many of the minor players are kept from view. This results in excessive compliance costs for the larger companies and, simultaneously, reduces the risk of being caught in respect of minor firms not keeping to the rules.

53 One respondent observed that along broad lines the administrative charges have not been well mapped out. They should actually have been examined within three years of introducing the Wfd (2006). This had not happened.

Appendix A Questionnaire in detail

Paragraph 1.2 discusses the key research question. This appendix gives the research questions to be answered for each component of commission policy.

Table A. 1: Research questions with reference to each commission rule

Rule	Research questions

Remuneration transparency
- Services statement
- Qualitative statement of to provider
	- Do the advisers/intermediaries supply the information required about remuneration?
	- Does this happen unsolicited, or does the consumer have to ask for it?
	- Does the consumer understand the information about remuneration?
	- Does the consumer have insight into (the bandwidth of) the adviser/intermediary's remuneration?
	- Has there been a shift from commission to other forms of remuneration in advisers/intermediaries' remuneration (hourly fees, subscriptions, etc.)?
	- Do advisers/intermediaries supply the services statement? If so, is this done in time?
	- Is the consumer familiar with the services statement?
	- Does the services statement help the consumer to gain an insight into the adviser/intermediary's remuneration and the specific services linked to this?
	- Does the consumer compare the remuneration (services statements) of various advisers/intermediaries?
	- Does the consumer have an insight into the adviser/intermediary's remuneration for recommending a specific financial product in the pre-contractual phase?
	- Does the consumer compare various advisers/intermediary's remuneration for recommending a specific financial product in the pre-contractual phase?
	- Does the consumer compare the adviser/intermediary's remuneration for recommending various financial products in the pre-contractual phase?
	- Does this information sometimes result in another adviser/intermediary or the direct writing channel being chosen? If so, how often?
	    • Has remuneration transparency (commission and services statement) had an effect on the consumer's choice in respect of the adviser/intermediary?
	    • Has remuneration transparency (commission and services statement) had an effect on the consumer's choice in respect of a financial product?
	- Has remuneration transparency (commission and services statement) had an effect on the consumer's choice in respect of a distribution channel?

Remuneration transparency	- How often does the consumer use the direct channel?
	  • In such cases, does the provider supply qualitative information about the distribution costs?
	  • Is this information comprehensible to the consumer?
	  • In such cases, does the provider supply a statement of costs?
	  • Does this statement provide the consumer with an insight into the scope and nature of the providers' services?

Table A. 1 continued: Research questions in respect of each commission rule

Rule	Research questions
Balancing rule and Refunding rule	- Has there been a shift from brokerage commission to renewal commission in advisers/intermediaries' remuneration? - Are advisers/intermediaries less governed by remuneration incentives (product bias) when recommending financial products? - Are advisers/intermediaries less governed by remuneration incentives (provider bias) when recommending a provider? - Does a (more) sustained relationship exist between the adviser/intermediary and the consumer? - Is there a (more) proportional spreading of a product's costs over the term of the product? - Have the consumer's costs decreased when transferring to another financial product?
Inducement standard	- Have recommendations made by advisers/intermediaries become more focused on the interests of the customer? - Is the customer recommended an appropriate financial product regardless of the adviser/intermediary's earnings from that product? - Are the efforts made on the customer's behalf by the adviser/intermediary and the remuneration received for this in proportion? - Is there a more sustained relationship between advisers/intermediaries and consumers? - Are there fewer instances of mis-selling?

Source: SEO Economic Research based on a briefing from the Ministry of Finance, 21 April 2010

Appendix B Sources

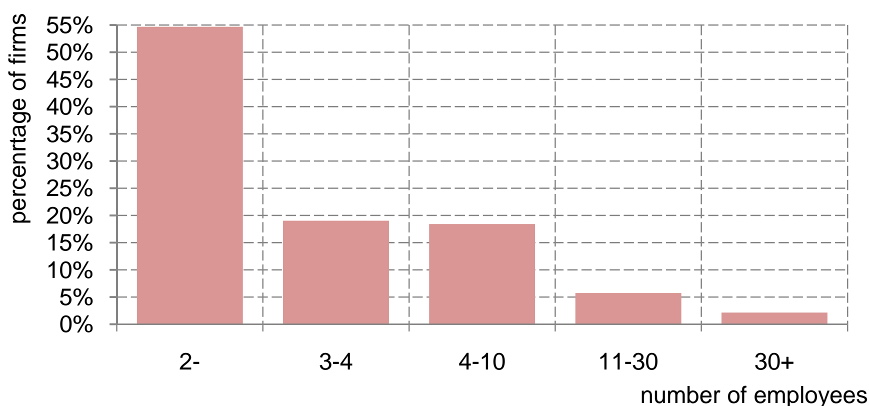
Appendix B.1 Consumer survey

A survey was conducted especially for this report from among consumer households (taken from the TNS Nipo consumer panel) that had recently acquired or inquired about a complex financial product. The 1,062 respondents were questioned about how they had been informed by intermediaries and/or providers, and about the degree to which the information had affected their decision-making process.

Appendix B.2 Intermediary survey

A survey was sent out especially for this report to the management at firms of intermediaries and advisers licensed for life insurance and/or mortgage broking. The invitation was accompanied by an appeal from the Minister of Finance to participate in the study. 1,308 of the 6,717 firms approached (19.5%) responded positively to that appeal. The group of respondents was in line with the group as a whole of more than 8,900 licence holders in terms of sizes of firm and types of licence. Based on the number of respondents and this proportionality, this group of respondents can be considered representative of the sector.

Figure B-1: Respondents according to size of firm



The intermediaries were questioned about their familiarity with the existing regulations, the way in which they interpreted service and commission transparency, and the consequences of the various aspects of regulation on business practice and the relationship they had with their customers.

Appendix B.3 Interviewees

R. Bavelaar, *De Hypotheekshop*
L. de Boer, J. van der Schoot, H. Mahadew, *Netherlands Association of Insurance Companies*
A. van den Bol, W. Steenbeek, *Hypotheekvisie*
J. Bos, *Nibud*
A. Dolders, *Legal & General*
K. Dullemond, *KD-Advies*
E. Feitsma, *Netherlands Bankers' Association*
R. Goedhart, *Ordina / Rob Goedhart Kennismanagement Persoonlijke Financiën*
C. Kielstra, C. Rosenbrand, OVFD (Association of *Financial Services Organisations)*
T. Kockelkoren, M. Frijlink, A. Lierens, R.J. van Loon, *Netherlands Authority for the Financial Markets (AFM)*
E. von Koczian, *StFD*, F. Treur, *Insurance Statistics Centre*
M. Ligtlee, *Vereniging Eigen Huis*
B. Millenaar, *De Hypotheker*
M. Mons, *IG&H Consulting & Interim*
R. ter Mors, *Avero Achmea*
J. Oosterbaan Martinius, *D&O*
T. Schoonbergen, *DAK*
B. Veldhuis, A. Kamperman, *Adfiz (Netherlands Association of Financial Intermediairies)*
C. van Vredenburgh, R. Dorscheid, *Dutch Consumers' Association*
J.W. Wabeke, E.J. Heck, S.W.A. Kelterman, *Insurance / Financial Services Complaints Body Ombudsman (KiFiD)*

Discussions were held additionally with a variety of consultants and intermediaries for background information.

Appendix B.4 Other sources of information consulted

Stichting Financiële Dienstverlening (StFD)

The **Stichting Financiële Dienstverlening** (StFD) is self regulation body, supported by eight professional bodies of financial service providers, that supports intermediaries and advisers in compliance with the Financial Supervision Act (Wft). Each year, the StFD sends out a questionnaire (known as the *Self-Assessment*) to its more than 8,000 participating broker's firms. The questionnaire chiefly discusses matters relating to the firms' compliance conduct, but it also discusses financial information, such as the size and composition of the turnover from the various market segments, staffing levels, and other business. The StFD gives feedback to its participants concerning replies that point to non-compliant conduct.

For the purposes of this report, the StFD put information at the researchers' disposal on an anonymous basis. The data have been analysed with a view to ascertaining how the firms are picking up and internalising the regulations and at what speed, ascertaining where there may be

obstacles and whether specific groups exist that are conforming better or worse than others to the regulations.

The number of participants in the Self-Assessment is on such a scale as to make its information representative by definition of the whole distribution channel.

Insurance Statistics Centre

The Insurance Statistics Centre (CVS) is the statistical agency of the Netherlands Association of Insurance Companies. The CVS gathers data about the insurance sector. The CVS has provided quantitative insights into developments in the interrelationships of distribution channels for various types of products.

NVA benchmark studies

Up to and including 2007, the professional body known as the Dutch Insurance Brokers' Association (NVA) –now merged within Adfiz – had a benchmark study carried out among its affiliated firms. The published reports for these studies include insights into the size and composition of turnover. Unfortunately, no data are available post-2007. Therefore, the information from these studies serves more as a benchmark for a part of the market than it does as a source of information for the situation since introduction of the regulations.

Owing to its limited number of respondents (approximately one hundred) and because, on average, it is larger firms which are affiliated to the NVA, these data are not representative of the whole market. On the other hand, the degree of differentiation between these firms is minor. In processes and outcomes they are very homogenuous, also in the composition of turnover. As a result, these data can also be interpreted (with some reservations) as representative of the sector.

SEO/Assurantiemagazine

On the occasion of Assurantiemagazine's fifth conference (May 2009), SEO Economic Research was commissioned by the publication to conduct a study in 2009 into the experiences of insurance firms with the current 'transformation of consultancy practice'. 801 subscribers to the AmWeb Newsletter shared their views via an internet survey. The results were presented at the conference.

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