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DEUTSCHE WELLE

Investment | 30.06.2011

Germany imposes new rules on financial advice

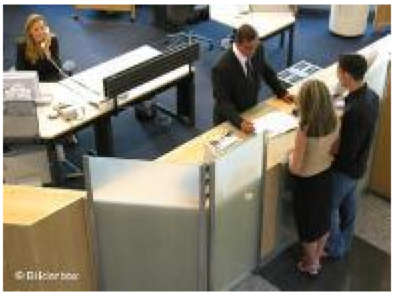
There's even more paper involved in financial consulting now

As of July 1, financial advisers in Germany will be required to give investors information brochures on products they recommend. The regulation is meant to increase transparency although not everyone thinks it will work.

When advisers working for a bank or financial services company recommend a particular stock or bond to an investor, as of July 1 they will also have to hand over an information leaflet laying out how the particular financial instrument will work, what risks are involved and how market fluctuations can affect future yields.

The law, spearheaded by German Consumer Affairs Minister Ilse Aigner, is meant to increase transparency by allowing investors to clearly weigh the risks and benefits of an investment and even compare various financial instruments offered by different institutions.

"Investors in Germany will now be better protected against bad advice," she said. "The new information brochures will lead to more transparency in the banking sector and to an appreciable strengthening of competition."



The new rules are meant to inform clients of the risks and benefits of investments

Consumer protection advocates have long complained that banks hide costs from customers and withhold information on risk.

While some banks already offer these information sheets, called PIBs in German, with their investment advice, the new law makes it a requirement for all institutions recommending stocks, bonds, certificates, options, futures and other financial instruments.

For European investment funds, an EU directive applies which requires banks provide a standardized summary called a "Key Investor Information Document" (KIID). It tracks a fund's value over a five or ten-year period and rates risk on a scale of one to seven.

Keeping it simple

All the information in a PIB is supposed to be contained on two standard-sized sheets of paper, or for very complex financial products, three. The most important numbers are to be listed such as costs involved, risks, possible yields and maturity dates.

"People often say after the fact they didn't know what they were actually buying," Manfred Jäger-Ambrozewicz of the Cologne Institute of Business Research, told Deutsche Welle. "With this, we're getting a more standardized way to presenting information. I think it's important."

Banks can be fined if they do not present customers the information either in printed or electronic form for the financial instruments they recommend, before a deal is closed. If no advice was given if, say, an investor bought stocks online, no PIB is required.

While the KIID has a standardized form, the PIB does not, which is one of the main issues critics of the plan have voiced.

"This is a good step on the path we need to be on, but it doesn't go as far as it should," Gabi Trillhaas, managing director of exameo, a consultancy focusing on information provided in the financial services sector, told Deutsche Welle.

Lack of standard format

The Zentrale Kreditausschuss, an umbrella group of the German credit services sector, has issued a recommended, standardized model for its PIB information sheets. But financial institutions are not required to use it.

A survey carried out by exameo found that only 36 percent of bank and insurance customers actually understood the product information that institutions provided. The new law could help clarify matters, if banks dropped some of the legalese.

"But language that is comprehensible to people often needs more space than obscure legal formulations," Trillhaas said. "Since space on these brochures is limited to two pages, it might be hard to get all the information on there in an understandable way."

Comprehension is also a concern to the German Share Institute (DAI), whose director, Franz-Josef Leven, said there is already good information out there about financial products, but that basic financial literacy is lacking, which can lead to bad investment decisions.

He also said the law's requiring information sheets for almost all financial product puts a heavy administrative and cost burden on banks' shoulders. The results could be that banks just pick a few products to create PIBs for.

"For bigger stocks, it will probably be fine," he told Deutsche Welle. "But for those in the second or third row, I don't know if banks are going to have that information drawn up by tomorrow."

But consumer advocates want to see more regulations on the information. The Association of Consumer Protection Agencies has welcomed the law, but has criticized the fact that investors only receive the PIB during a consultation.

Its financial expert Dorothea Mohn told Berlin's Tagesspiegel newspaper that a better strategy would be to put information on all the products on the Internet so investors could compare and contrast before sitting down with an adviser.

Deceptive security?

Planned EU regulations could soon change the new German rules

Others have pointed out that the calculation of risk of a particular investment is anything but an exact science. While European government bonds were considered low risk five years ago, the picture today is quite different.

So while historical data can serve as an indication of future performance, it can also lead to a false sense of security, financial experts say.

Others worry about a lot of work and expense wasted, and that Germany might be jumping the gun with the new law. While the PIBs are mandatory as of July 1, in one year they might disappear altogether, or at least change dramatically.

The EU is finalizing new product information rules called PRIP, or Packaged Retail Investment Products, which are set to come online in 2012. According to Georg Baur of the Federal Association of Private Banks, "after that, every PIB will have to be redone."

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