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Dear Sir

Consultation paper CP116 - Intermediary Inducements

Lloyd's welcomes the opportunity to respond to the Central Bank's consultation paper CP116 on intermediary inducements. In respect of risks located in Ireland, Lloyd's underwriters write non-life and life insurance products without an investment component and reinsurance of such business. Our comments are made in the light of this. Before answering the consultation questions in detail, we would like to outline Lloyd's general principles regarding the regulation of insurance intermediary remuneration arrangements.

Lloyd's general principles regarding insurance intermediary remuneration arrangements

1. Regulations on insurance intermediary remuneration arrangements should be appropriate and proportionate to *the nature of the insurance intermediary's activities*. It appears to be a premise of some proposals in the consultation paper that all insurance intermediaries in Ireland have the same or similar business models. We feel that the proposals do not take into account the operations and activities of insurance intermediaries that transact some or all of their business on a wholesale basis and, consequently, do not have any contact with consumers or provide advice or product recommendations to consumers.

2. Regulations on insurance intermediary remuneration arrangements should be appropriate and proportionate to *the nature of the insurance product*. A level playing field across all financial services sectors is not necessary or appropriate because different rules for each financial services sector can still achieve the objective of protecting consumer interests. Different products (insurance products without an investment component, insurance based investment products, other investment products and mortgages) present different product risks and sales risks and should be regulated accordingly. Indeed, this is

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why IDD[1] and MiFID II[2] contain different remuneration rules for insurance products without an investment component, insurance based investment products and other investment products.

3. Lloyd's fully supports the aim of IDD to increase consumer protection and the enhancement of requirements for the disclosure of information to customers and the conduct of insurance distributors set out in Chapter V (Articles 17-25) of IDD. This chapter sets out an appropriate and proportionate approach for the remuneration arrangements of firms distributing insurance products that do not have an investment component, which adequately protects the interests of consumers. This approach was agreed following significant negotiations in consideration of the particular circumstances and risks in this sector. Lloyd's believes that the application of differing and more restrictive requirements designed to deal with risks that are not applicable for general insurance products could have a detrimental impact on the cost and availability of cover to Irish consumers, without delivering meaningful benefits.

Response to consultation paper questions

Section 3.1 – Acceptable inducements

Q1. Do you see any reasons why the Code should not be amended as set out above?

Yes.

The requirements in MiFID II[3] that remuneration must "enhance the quality of the relevant service" and in IDD[4] that it must not "have a detrimental impact on the quality of the relevant service", in respect of insurance based investment products only, are appropriate for those products because of the nature of those products and how they are sold.

Insurance products that do not have an investment component are short term products of usually 12 months. Standard commission[5] is earned by the insurance intermediary at the beginning of each policy period and is based on the amount of the annual premium. In contrast, investment products and insurance based investment products are long term products that continue for many years. The insurance intermediary may earn commission based on the value of the investment over the full product term but with all of the commission being paid at the beginning of the term. This model can provide conflicting incentives to the insurance intermediary. Insurance intermediaries dealing with insurance products that do not have an investment component are not subject to the same incentive.

[1] EU Directive 2016/97 on insurance distribution.
[2] EU Directive 2014/65/EU on markets in financial instruments.
[3] Article 24(9)(a) of MIFID II.
[4] Article 29(2)(a) of IDD.
[5] Commission that is calculated as a percentage of the premium and that is paid by the customer and retained by the insurance intermediary.

Large front-loaded commissions deducted from the premiums for insurance-based investment products, or tail-commissions that provide a long-term income stream to an insurance intermediary from a single transaction, have the potential to alter the benefit the customer ultimately receives from such products. In contrast, standard commissions do not have the ability the alter the value of the cover that is received by purchasers of insurance products that do not have an investment component, and therefore this can be assessed straightforwardly in comparison to the overall cost of purchase.

For the above reasons, we believe that the first criteria for what is an acceptable inducement should not apply to insurance products that do not have an investment component.

The requirement in Article 17(3) of IDD that prohibits an insurance intermediary from having a remuneration arrangement that would incentivise it to recommend a particular product to a customer when a different product that would better meet the customer's needs is sufficient for insurance products that do not have an investment component. The second and third proposed criteria for what is an acceptable inducement are aligned with this article and are not inappropriate for such products.

Q2. Do you see any reason why, for example, insurance intermediaries should not be subject to the requirement that inducements must enhance the quality of the service rather than the requirement that an inducement is not detrimental to the quality of the service as is required under the IDD? If so, please set out those reasons.

Insurance intermediaries that distribute insurance products that do not have an investment component should not be subject to the requirement that inducements must enhance the quality of the service for the reasons outlined in the answer to Q1.

Q3. Do you agree with the conditions in schedule 5 of the MiFID Regulations 2017 [EU (Markets in Financial Instruments) Regulations 2017], as set out above, that describe how an inducement enhances the quality of the service? Please explain your answer.

The conditions in Article 1(2) of Schedule 5 of the MiFID Regulations 2017 are not applicable to the sale to consumers of insurance products that do not have an investment component. These products are transactional in nature, even when advice is sought regarding the initial purchase or renewal of the policy. The service that the consumer will receive from the insurance intermediary post-purchase is most likely to be administrative assistance regarding the submission of a claim under the policy, which is a discrete event, and there will rarely be any need for advice during the policy period. This is in contrast to investment products where the consumer may wish to obtain periodic investment advice from the intermediary after the investment product has been taken out and for the duration of his relationship with that intermediary.

Q4. What other examples do you consider would enhance the quality of the service? Please set out those examples in detail.

We do not have any further comments to make regarding this section.

Q5. Do you foresee any practical difficulties arising from the implementation of this proposal? Please set out those difficulties in detail.

The term “quality of the relevant service” is open to subjective interpretation and without prescriptive guidance. However, please refer to our answer to Q3.

Q6. Do you have any views on what, if any, unintended consequences may arise in implementing this proposal? Please explain your answer.

Please refer to our answer to Q5.

Section 3.2 - Inducements deemed to be conflicts of interest

Section 3.2.1 – Inducements linked to targets that do not consider the consumer’s best interests

Q7. Do you have any views on the proposal that inducements contingent on achieving targets that do not consider the consumer’s best interests, including profit targets, volume targets, and targets linked to business retention, are deemed to be conflicts of interest and must be avoided? Please explain your answer.

Profit related commission is typically used by insurers to remunerate insurance intermediaries that distribute products under an agency contract (known as a binding authority agreement or a delegated underwriting agreement) that delegates authority to the insurance intermediary to underwrite and bind business on behalf of the insurer. At Lloyd’s, such an insurance intermediary is referred to as a coverholder.

In the case of a binding authority agreement, the insurer’s objective is that the insurance intermediary will underwrite profitable business within the parameters that the insurer has determined in the agreement. In its capacity as agent of the insurer, the insurance intermediary owes fiduciary duties to the insurer and such commissions reflect this position. Remunerating an insurance intermediary according to the level of profit achieved by the portfolio of business it has underwritten is aligned with its role as an agent of the insurer, and incentivises it to focus on his principal’s interests. Furthermore, incentivising an insurance intermediary to underwrite profitable business on behalf of its principal has clear prudential benefits for the insurer and helps to create a stable and sound insurance market in the long term, which also benefits consumers.

However, Lloyd’s does not believe that payment of profit-related commission to an insurance intermediary that has a binding authority agreement from an insurer creates a conflict of interest, or is contrary to Article 17(3) of IDD, for the following reasons.

Firstly, profit related commission is calculated based on the performance of the portfolio over a number of years. Due to this system, a coverholder does not receive any short term

benefit when it underwrites a risk under a binding authority agreement as he will not receive the profit-related element of the remuneration until a few years afterwards, provided that the portfolio has returned the required level of profit.

Many insurance intermediaries that have binding authority agreements transact business under the agreement on a wholesale basis and do not have direct contact with consumers. As they are not recommending a particular product to a consumer no conflict can arise. Therefore, profit related commission should be permitted to be paid to intermediaries acting on a wholesale basis, even if it is prohibited for intermediaries that have direct contact with the client.

In conclusion, we note that IDD does not prohibit any particular form of remuneration and our view is that the objectives of IDD can and should be achieved without introducing such prohibitions.

Q8. Do you have any views on what, if any, unintended consequences may arise in implementing this proposal? Please explain your answer.

The prohibition of profit-related commission will result in insurers only being able to pay standard commission or a fixed fee per policy to insurance intermediaries. As insurance intermediaries will still need to receive enough income from an insurer to cover their costs and run their business, the amount paid in standard commission or fixed fees will become at least equivalent to the insurance intermediary's previous income from all types of remuneration. This could have a number of consequences.

The insurance intermediary will no longer need to have regard to the quality or the profitability of the business written, particularly in the case of a fixed fee per policy. The effect will be the same as is seen in a volume based remuneration system, which the CBI proposing to prohibit.

If a coverholder is not focused on underwriting for profit then there is a significant risk that as the portfolio develops it will make a loss, the insurer will decide to withdraw the binding authority agreement and consumers will lose the opportunity to have continuity of cover. It will also reduce the number of potential insurers that consumers may access for certain products, thus reducing competition in that segment of the market. This will diminish the range of specialist insurance products available to consumers in Ireland and potentially increase rates for some products in the Irish insurance market. Both will have an adverse effect on consumers. Many Lloyd's coverholders distribute niche products that are not usually offered by local insurers, and they have specialist product knowledge that is used to provide bespoke solutions to consumers.

A prohibition on profit-related commission will not necessarily result in lower costs for consumers. If an insurance intermediary can only accept standard commission and/or a fixed fee per policy it will have to factor in some uncertainty regarding the number of policies that it will issue and the number of claims that it will handle. This could result in fees that are greater than the amount of the previous commissions. If the insurers are able and willing to

pay this higher fee, all or some of it is likely to be passed on to consumers. Alternatively, some insurers may choose to reallocate capacity elsewhere.

The number of insurance intermediaries that have binding authority agreements from insurers will decrease leading to reduced availability of cover for consumers. It is highly likely that if, as expected, such insurance intermediaries incur higher costs (as explained above) that cannot be met by insurers, they will find it hard to stay in business leading to consolidation in the insurance intermediary sector. When insurance brokers in Norway and Denmark were prohibited from receiving any commission several years ago and had to move to a fee based system, there was a notable decrease in the number of broking firms in the market as mergers became necessary. Fewer insurance intermediaries can reduce choice and competition in the market, especially for specialist insurance products. Access to the right products is important for consumers as well as price.

Consumers may decide not to purchase cover for non-compulsory classes of business leading to lower insurance penetration rates. This will result in less financial protection for households, consumers being more exposed to unmanageable financial losses, reduced economic activity and potentially higher costs for other consumers as the benefits of risk pooling are not exercised.

If insurers are not permitted to pay profit-related commission, they may use other methods to ensure that the insurance intermediary's portfolio does not become loss-making. For example, they may restrict the types of risk that may be accepted under the terms of the binding authority agreement, apply lower claims ratio thresholds, or increase premium rates in order to compensate for an expected deterioration in the underwriting performance of the portfolio.

Q9. Do you foresee any practical difficulties arising in the implementation of this proposal? Please set out those difficulties in detail.

A prohibition on profit-related commission would require insurers and insurance intermediaries that currently use this system to devise new business models and new remuneration arrangements. This includes approximately 45 Lloyd's coverholders. This will be a significant change for insurers and insurance intermediaries that will require existing binding authority agreements to be renegotiated as well as changes to existing IT, financial and operational systems. Therefore, we strongly recommend that if this prohibition is implemented, the period of time between the publication of the changes to the Consumer Protection Code and the effective date of the changes is at least 18 months in order to minimise disruption to the insurance intermediary market and to the products and cover available to Irish consumers.

Section 3.2.2 - Inducements linked to size of mortgage loan

Q10. Do you have any views on the above proposal? Please explain your answer.

This section does not apply to the Lloyd's market as Lloyd's underwriters do not provide mortgage products.

Q11. Do you have any views on what, if any, unintended consequences may arise in implementing this proposal? Please explain your answer.

Please refer to our answer to Q10.

Q12. Do you foresee any practical difficulties arising in the implementation of this proposal? Please set out those difficulties in detail.

Please refer to our answer to Q10.

Section 3.2.3 - Soft commission

Q13. Do you have any views on the proposed deletion of provision 3.36 of the Code, relating to soft commission agreements? Please explain your answer

We do not have any objections to this deletion and its replacement with the definition of 'minor non-monetary benefit'.

Section 3.2.4 - Recommendations where conflict of interest exists

Q14. Do you have any views on the above proposal? Please explain your answer.

This proposal will not apply to intermediaries that transact business on a wholesale basis and thus do not provide advice or recommendations to consumers.

In respect of intermediaries that do provide advice or recommendations, it will reduce the competition between the insurers that they work with as each insurer will have to pay the same level of commission to an insurance intermediary for a particular type of product. Insurers should be able to negotiate remuneration arrangements based on the nature of the activities that the insurance intermediary is going to perform in respect of the product to be distributed and the nature of the service that is going to be provided. Insurance intermediaries have different business models and not all intermediaries perform the same activities for all products. An insurance intermediary with a binding authority agreement will perform various activities such as risk analysis and assessment, calculating premiums, collecting premiums, issuing policy documents, preparing data reports for the insurer, claims administration, handling clams (in specified cases). This is a greater number of activities than would be undertaken by an insurance intermediary without underwriting authority and should be remunerated accordingly.

It is unclear how it should be determined that products are in the same "range" and this is open to interpretation. For example, if there are two household insurance products offered

by two different insurers and one includes legal expenses cover and the other one doesn't, are they in the same range of products?

Q15. Do you have any views on what, if any, unintended consequences may arise in implementing this proposal, including any impact on consumer choice? Please explain your answer.

It is possible that insurance intermediaries will seek to equalise the level of commission received from different insurers in order to eliminate potential for conflict of interest. This would be likely to drive up the commissions they receive from different insurers to the highest common denominator. This will increase the ultimate cost to the consumer.

Q16. Do you foresee any practical difficulties arising in the implementation of this proposal? Please set out those difficulties in detail.

We do not have any further comments regarding this section.

Section 3.2.5 - Conflicts of interest policy and record-keeping requirement

Q17. Do you have any views on the proposal that a written conflicts of interest policy should also specify procedures to be followed, and measures to be adopted, by the regulated entity, in order to avoid conflicts of interest relating to inducements? Please explain your answer.

As explained in the answers to Q7 and Q8, we do not believe that profit related commission gives rise to unmanageable conflicts of interest and that the receipt of them by an insurance intermediary should be prohibited. Therefore, we do not think that an insurance intermediary's conflicts of interest policy should be required to state how it will avoid a conflict of interest relating to this type of remuneration.

Q18. Do you have any views on the proposal that records must be retained to demonstrate how conflicts of interest arising from inducements have been avoided for each transaction?

We do not have any further comments regarding this section.

Q19. Do you foresee any practical difficulties arising from the implementation of this proposal? Please set out those difficulties in detail.

Please refer to our answer to Q18.

Q20. Do you have any views on what, if any, unintended consequences may arise in implementing this proposal? Please explain your answer.

Please refer to our answer to Q18.

Section 3.3 - Independence

Q21. Do you have any views on the proposal that an intermediary may only describe itself or its regulated activities as independent, where it does not accept and retain a third party inducement for the provision of advice, other than a minor non-monetary benefit which is capable of enhancing the service to a consumer? Please explain your answer.

We do not have any comments to make regarding this section.

Q22. Do you foresee any practical difficulties arising from the implementation of this proposal? Please set out those difficulties in detail.

Please refer to our answer to Q21.

Q23. Do you have any views on what, if any, unintended consequences may arise in implementing this proposal? Please explain your answer.

Please refer to our answer to Q21.

3.4 Transparency of inducement arrangements

Q24. Do you have any views on the proposal to introduce an obligation for intermediaries to publish comprehensive details of inducement arrangements with product producers with which they have an appointment? Please explain your answer.

Lloyd's fully supports appropriate disclosure in writing of remuneration arrangements to consumers, before the conclusion of the contract, in order to assist them in making an informed decision about the product and the intermediation service they are offered. This is required in Article 19 of IDD.

However, we do not think that it is appropriate for insurance intermediaries to be required to publish this information in their offices or on their websites. It is commercially sensitive information for both insurance intermediaries and the insurers they work with. This is not a requirement of IDD or MiFID II. In business generally, it is not considered necessary for a firm to publish its commercial terms with its suppliers to prevent consumer detriment. Publication of this information in respect of every product provided by every insurer is not likely to help consumers make an informed decision about their particular purchase and it is going to be more confusing than helpful. In particular, intermediaries that deal with many producers or offer many products would have to publish and maintain an enormous amount of information, which would be a disproportionate burden compared to providing the IDD-required disclosure to consumers for the product or products that they are considering. Only disclosing the remuneration arrangements for the products offered to the particular consumer will also be more useful than requiring consumers to sift through a large volume

of potentially irrelevant information on products that they are not considering in order to find the details relevant to them.

Q25. Do you think the Central Bank should prescribe the format and content of the inducement arrangements summary document? If so, please provide details of the content you think should be included.

No. Insurance intermediary firms have different business models and various remuneration arrangements in place. The CBI would need to review each of these in detail in order to formulate a prescribed template. It is important that remuneration information is disclosed in a manner that is clear, accurate and comprehensible[6].

Q26. Do you have any views on the proposal that firms must retain records to demonstrate how the inducement arrangements summary document was brought to the attention of the consumer? Please explain your answer.

We believe it is good practice for an insurance intermediary to keeping a record of the remuneration information that has been disclosed to a consumer.

3.5 Proposed new definitions

Q27. Do you have any views on the proposed definitions of 'inducement'? Please explain your answer.

We note that there is currently no definition of "remuneration" or "commission" in the Consumer Protection Code 2012 so a definition would be helpful. However, having a definition of "inducements" that relates to all types of remuneration paid by an insurer or product provider implies that all types of such remuneration are designed to influence the insurance intermediary's behaviour which is not the case. Standard commission is designed to cover the costs the insurance intermediary incurs in distributing the product, e.g., time spent on collating risk information for the insurer, advising the consumer, collecting premiums and issuing renewal notices.

We would suggest the same definition of "remuneration" as is proposed for "inducement".

Q28. Do you have any views on the proposed definition of 'minor non-monetary benefit'? Please explain your answer.

We do not have any comments to make regarding this question.

Q29. Do you agree with the above examples of minor non-monetary benefits? Please set out your reasons.

[6] Article 23(1)(a) of IDD.

Yes. Guidance should be provided as to what is considered to be within this new definition of minor non-monetary benefit, otherwise it is open to subjective interpretation.

Q30. Are there any additional minor non-monetary benefits that you think should be included? Please explain your answer.

We believe that the proposed definition is satisfactory.

Q31. Would you set a monetary limit, as a guide, on a minor non-monetary benefit? If so, what limit would you consider appropriate and why?

No. A monetary limit would have to be referenced to be per person, per firm, per event, per product, per year and so on, and the limit would need to be regularly reviewed and updated. It will also encourage insurers and product providers to provide the benefit in such a way that it comes under the monetary threshold set, thereby complying with the letter not the spirit of the rule. It also defeats the purpose of it being referred to as a non-monetary benefit.

We trust the above is helpful to your understanding of Lloyd's position on this important issue. If you wish to discuss the matter further or require any clarification on any of the above points, I would be more than happy to meet with you or provide further information.

Yours faithfully

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