An Chomhairle Pinsean
The Pensions Council

Intermediary Inducements – Enhanced Consumer Protection Measures

March 2018

This is the response of the Pensions Council to the Consultation Paper CP116 issued by the Central Bank in November 2017 on "Intermediary Inducements – Enhanced Consumer Protection Measures".

The Pensions Council (An Chomhairle Pinsean) was set up to advise the Minister for Employment Affairs and Social Protection on matters relating to policy on pensions. The Council's objective is to represent and protect the consumer interest and help to ensure that the pensions system has a far stronger consumer focus.

Executive Summary

Inducements to intermediaries result in a direct cost to the consumer. Therefore from the consumer's perspective inducements should result in a service and/or other benefits for the consumer at least equivalent in value to the corresponding recovery made from their retirement contributions and account, and not interfere with the intermediary's duty to act in the consumer's best interests.

The proposed new conflicts of interests provision in the Consumer Protection Code should apply equally to insurance intermediaries as it does in the MIFID II Regulations, to ensure consistency between different forms of intermediaries and products; all of the key MIFID-equivalent requirements should be included.

While generally inducements contingent on the intermediary achieving targets are unlikely to be aligned with the consumer's best interests, there may be examples where target-driven inducements do provide some indirect benefits to the consumer, e.g. via increased allocation rate. To avoid "churning" the Code should include a provision dealing explicitly with potential conflicts of interest inherent in the use by providers of an early encashment charge system, which can allow the intermediary to generate fresh initial commissions at the end of each early encashment charge period.

A range of product charge and commission options from an insurer for the same product can be to the consumer's benefit in some cases; however lack of disclosure of the range of options can damage consumers. The proposal that intermediaries may not recommend a product from a range that offers different levels of inducement may not be workable in practice and may have unwanted effects. In preference, full disclosure in writing of the full range of potential inducement options available on a product and on

comparable products from other insurers, and explicit consumer consent on the application form should be required.

Outright banning of commission could have unintended consequences, e.g. an "advice gap" where consumers no longer seek advice if obliged to pay a fee up front rather than taken from their policy value. If the use of the description "independent" is restricted to intermediaries who do not take commission, it is likely that intermediaries may increasingly describe their services as "fair analysis" instead, but the conditions to be met to describe "fair analysis" advice in the Code are vague, and the term is not one readily understood by consumers.

Intermediaries should be required to display a comprehensive list of commissions/inducements from all producers who offer them. This list should be brought to the consumer's attention at point of recommendation of a product, rather than at point of signing contract. If the Central Bank prescribed the format and content of the summary document, consumers would be better able to compare amongst different intermediaries. Similar requirements could be placed on insurers and providers, to summarise and disclose the range of inducement terms they currently pay to intermediaries and to their own staff.

The proposed definition of "inducement" leaves ambiguity as to whether the deduction and payment by a provider of client-mandated commissions/fees from pension arrangements is included. The Code should specifically list allowed minor non-monetary benefits.

Introduction

The Pensions Council carried out two surveys in 2016 and 2017 of ARF[1] and Buy Out Bond[2] charges. In the 2016 ARF survey, the Council's report noted that a consumer who arranges an ARF with a life assurance company is likely to have two separate charges (in addition to other investment related charges) applied to his or her ARF account: the insurer's own charges and recovery of inducements paid by the insurer to the intermediary. The 2017 survey on Buy Out Bond charges made similar findings.

Therefore, where inducements (typically commissions) are paid by an insurer to an intermediary in respect of individual pension policies, this results in a direct cost incurred by the policyholder as the cost of the inducement is recovered by the insurer € for € from the policyholder's contributions or retirement account. As such, it follows that

[1] http://www.pensionscouncil.ie/en/Council-Opinions/Report-on-ARF-Charges.pdf
[2] http://www.pensionscouncil.ie/en/Council-Opinions/Report-on-BOB-Charges-.pdf

where inducements are provided by insurers to intermediaries in relation to pension policies, from the consumer's perspective this should result in a service and/or other benefits for the consumer at least equivalent in value to the corresponding recovery made from their retirement contributions and account and not interfere with the intermediary's duty to act in the consumer's best interests.

Replies to Questions 1 - 6

The Council notes the proposed new conflicts of interests provision in the Consumer Protection Code (Code) setting out the criteria that must be met in order for the payment and acceptance of inducements to be deemed acceptable. The Council agrees that this provision should apply equally to insurance intermediaries as it does in the MIFID II Regulations[3], in order to ensure consistency between different forms of intermediaries and products.

The Council welcomes any initiatives designed to enhance the quality of service provided by intermediaries to consumers, which do not impair the intermediary's obligation to act honestly, fairly and professionally in accordance with the best interests of the consumer, and do not have the potential to impair the intermediary's obligation to satisfy the suitability requirements set out in Chapter 5 of the Code.

However in relation to the proposed new conflicts of interests provision in the Consumer Protection Code (Code) setting out the general criteria which must be met in order for the payment and acceptance of inducements to be deemed acceptable, some of the specific MIFID equivalent requirements are missing; in particular clarification of the circumstances in which an inducement will be considered to be designed to enhance the quality of the relevant service to the consumer, e.g. that the level of service provided must be proportional to the level of inducement received, and that ongoing inducement (e.g. trail commission) must be matched by the provision by the intermediary of an equivalent ongoing benefit or service to the consumer.

Without such specific details of the circumstances in which an inducement will be considered to be designed to enhance the quality of the relevant service to the consumer, insurers and intermediaries alike may find it difficult to demonstrate that particular inducements are acceptable. Where interpretations are inconsistent, this may not serve the consumer's best interest.

This issue can be alleviated by aligning the Code and MiFID regulations (schedule 5), in relation to acceptable inducements. It may also be important to clearly specify with guidance, examples of inducements which could be held to meet or to not meet the new criteria for acceptable inducements.

[3] Schedule 5, SI 375 of 2017

Replies to Questions 7 - 9

The reference to conflict of interest is taken to mean a situation in which the concerns or aims of two different parties are incompatible. Any inducements contingent on the intermediary achieving targets set by providers, including profit targets, volume targets, and targets linked to business retention, are, in the view of the Council, generally unlikely to be aligned with the consumers best interests, as the inducement is invariably designed to influence the intermediary to direct business to that provider and to act in the intermediary's own short term financial interests.

However there may be examples where target driven inducements do provide some indirect benefits to the consumer, where the intermediary rebates some of the benefit of the target driven inducement to the consumer, e.g. an increased allocation rate and lower charges, and hence might be considered to be in the consumer's best interests.

It may be important to differentiate between actual and potential conflict of interest. For example, it may be difficult for a supervisory body to demonstrate that, where inducements are contingent on targets, etc, that this represents an actual conflict of interest. The demonstration of potential conflict of interest is likely to be set at a lower bar.

In its 2016 ARF report, the Council noted that where a consumer is advised by an intermediary to move his/her ARF regularly (after the expiry of an early encashment period), the consumer's charges increase (by 0.6% pa in the example discussed on page 17 of the Council's report), because the consumer pays a new set of charges on each new ARF contract he or she enters into.

Therefore, consideration might be given to inserting a provision in the Code dealing explicitly with the potential conflicts of interest inherent in the use by providers of an early encashment charge system which can incentivise an intermediary to churn consumer policies at the end of each early encashment charge period (typically 5 years) in order to generate fresh initial commissions.

Replies to Questions 14,15 and 16

The Pensions Council surveys in February 2016 and February 2017 of ARF and Buy Out Bonds charges, respectively, levied on policies issued by life assurance companies through independent insurance intermediaries found that:

- All insurers offered intermediaries a range of commission options on such products. The remuneration chosen by the independent intermediary, from the palette of options offered by that insurer, is then funded by the insurer making a corresponding direct € for € recovery from the consumer's retirement fund.

- All insurers offered at least two different charging versions of the *same* product, under the same brand name. For example, in the ARF survey the Pensions Council found that eight insurers offered 23 different products, which combined with a wide range of commission options within most products, provides a bewildering choice of insurer charge/ remuneration options to the intermediary.
- The choice of product version and intermediary commission option by an intermediary from the range offered by an insurer, appeared to be largely hidden from the consumer through the use of codes to identify the particular products and commission options, and/or the insertion by the intermediary of the relevant code in an 'Office use only' section of the application form completed by the consumer. In some cases the commission option might be inserted on the application form *after* the consumer had completed and signed it, or at least could be.
- While some intermediaries may disclose to the consumer at the point of sale the range of commission options available within the *same* product and not just the commission option chosen by the intermediary, it is currently not mandatory for the intermediary to do so.

  The Pensions Council Survey on ARF charges, February 2016, concluded in relation to the issue of disclosure to the consumer of the range of product/commission options, rather than disclosure of the specific product/commission option chosen by the intermediary:

  "It also raises the question as to whether the consumer is and should be informed by the intermediary or insurer that there may be a lower charge (at particular benchmark durations, e.g. after 5 and 10 years) version of the same ARF product available, when a higher charge version (at those benchmark durations) is being recommended to the consumer. "

It is likely that insurers offer a complex range of charging and commission options to the intermediary for the same product, e.g. an ARF or Buy Out Bond, for competitive reasons, with competition in this context meaning competition between insurers for the *intermediary's* business and not competition between insurers for the consumer's business.

In turn the intermediary may demand from insurers a range of charging and commission options for the same product to allow differential charging for services, e.g.

- an intermediary may wish to charge lower commission for some consumers with larger investment amounts, or for an existing client;
- an intermediary may wish to charge lower commission than their normal charge in an individual case to compete on price with another intermediary

- an intermediary may wish to charge higher commission for some consumers with complex circumstances which demand a higher level of advice/service or for a client with a lower investment amount.

Therefore a range of product charge and commission options from an insurer for the same product can be to the consumer's benefit in some cases; but abuse by some intermediaries of the charging/commission flexibility offered can damage some consumers.

The key issue is not that the same products from which the intermediary makes a choice, carry different commission terms per se, but that this fact is withheld from consumers, and hence some consumers may not know that the product they have invested in in could have been secured at a lower price. It's what's *not* disclosed which can damage the consumers.

The Pensions Council recognises the good intentions behind the proposal that an intermediary would not be allowed to recommend a product from a range which offered different levels of inducement, as being in effect a 'belt and braces' enforcement of the general principle that an intermediary should avoid conflicts of interest arising from inducements and act in the best interests of the consumer.

However we believe that the proposal, while well intentioned:

- is not workable in practice (as currently drafted) in the case of individual pensions policies, where insurers offer a wide range of commission options to intermediaries under the *same* product.

  Without substantial modification, the proposal would seem to prevent an intermediary making *any* recommendation from the current range of ARF and Buy Out Bond policies as there is almost an infinite range of commission options available.

  Alternatively an interpretation of the proposal could be that an intermediary can first set and agree with the consumer a commission 'tariff', e.g. 3% initial + 0.5% pa trail, and having done that the intermediary can then pick from a product range which all offer a 3% initial + 0.5% pa trail commission option, and can not pick from products which do not offer such a commission option.

- might drive *up* commission rates and hence charges to consumer, as insurers would presumably withdraw lower commission options on products (which they may not receive substantial business), leaving only higher commission options.

- might lead to the market arriving at an informal commission 'norm' for particular product types, e.g. 3% initial commission + 0.5% pa trail commission for individual pension policies.

The proposal could lead to an informal return of the old 'Commissions Agreement' terms between insurers, albeit not an explication agreement. The 'norm' terms arrived at could well be higher than current average commission terms charged to consumers for similar products.

- incentivise intermediaries to charge that norm rate of commission for particular products and services and abandon the differential pricing it may currently adopt.
- would, for the reasons outlined above, blunt price competition between intermediaries; in effect the same product would have to carry the same commission terms, regardless of which intermediary sold it.
- implies that the only factor which can determine suitability is charges/commission terms, i.e. charges. For example, it's entirely possible that insurer A might offer a product at 3% initial commission and 0.5% trail commission which is more suitable (because of better fund options, financial standing of the insurer, service and/or lower charges in the long run) than a similar product from insurer B offering lower 2% initial and 0.5% pa trail commission.

The current flexible commission terms offered by insurers to intermediaries under the same product offers potential benefits to consumers in terms of potential price competition between insurers and between intermediaries, but only if the consumer is made aware of the range of commission options available and their impact on his or her fund value.

The Pensions Council therefore feels that the proposal might be amended to provide that where an intermediary recommends a product to a consumer as being the most suitable from a range of products which can all fulfil the same substantial financial need of the consumer but which offer different levels of inducement, the intermediary must disclose to the consumer in writing the full range (high and low) of potential inducement options available on that product and on comparable products from other insurers[4], and the consumer must explicitly consent on the application form to the specific inducement option chosen by the regulated entity on that product. In effect, the change would be that the intermediary inducement terms would be explicitly agreed between the intermediary and consumer (in the full knowledge of the full range of possible inducements) available, and not between the insurer and the intermediary as currently happens.

In addition the general obligation to avoid conflicts of interest caused by inducements would continue to apply.

[4] Where the intermediary offers advise on similar products from other insurers

We agree with the proposal that that a written conflicts of interest policy should also specify procedures to be followed, and measures to be adopted, by a regulated entity, in order to avoid conflicts of interest relating to inducements.

We feel that the requirement to retain records to demonstrate how conflicts of interest arising from inducements have been avoided for *each* transaction may further encourage providers and intermediaries to huddle around commission 'norms' for particular types of products, and hence make it easier for the intermediary to demonstrate an absence of a conflict of interest related to inducements in any individual case.

Replies to Questions 21 to 23

The reaction of most intermediaries to the independence requirements is highly likely to be cessation of the use the term 'independent' in describing the firm and its services, in order that they can continue to accept commissions from product providers to pay for the services they provide to their clients.

Commissions in and of themselves are not necessarily a negative (or rather, may be considered a necessary evil) – as set out in section 1 and section 2.4 of the Consultation Paper.

Outright banning of commission could lead to unwanted consequences such as an "advice gap", particularly at lower amounts of investment. The consumer research results set out in section 3.3 of the Consultation Paper make clear the value that consumers put on the term "independent". By limiting the use of this term to those intermediaries who do not accept any commission or inducement (other than a minor non-monetary one), there is the possible unintended consequence that some consumers may by-pass intermediaries who previously but could no longer use the term "independent". Such intermediaries may in fact be the most suitable financial advisors for some of these consumers, particularly where they offer fair analysis advice.

The proposal is in itself unlikely to have any beneficial impact on intermediaries as most consumers while professing a desire for 'independent' financial advice will not pay a fee (+ VAT) commensurate with the level of advice and service they require, unless that fee can be taken from their policy value. Advice will, in the vast majority of individual consumers, continue to be paid for by provider inducements.

Having said that, an intermediary who is only remunerated by consumer fee, not by commission allocated by the provider, is in the best position to avoid any conflict of interest when recommending a product to their client, and therefore the word "independent" is most accurately applied to such intermediaries. But, is this the understanding of consumers in relation to the description "independent", or are consumers more of the view that "independent" effectively means not a tied agent – i.e. that the intermediary will review the whole market for them?

It is likely that intermediaries may increasingly describe their services as 'fair analysis' rather than independent, but the conditions to be met to describe 'fair analysis' advice in the Code are vague, and the term is not one readily understood by consumers.

Replies to Questions 24 to 26

We are strongly in favour of the proposal that intermediaries be required to display a comprehensive list of commissions/inducements from all producers who offer them same. As outlined earlier, it is what is not disclosed that can damage consumers. The proposal will allow consumers the possibility of comparing available inducements and forming their own opinion as to what weight may possibly have been attached by the provider to the inducement in recommending a particular product.

The 2nd leg of the proposal is that, before concluding a contract for a financial product, the intermediary would be obliged to bring the summary document setting out the list of commissions/inducements to the attention of the consumer. By the time a contract is being finally signed off, the momentum may be so great that the consumer is disinclined to let anything stop it at that stage. Therefore it may be more appropriate for the intermediary to bring it to the consumer's attention at the point of recommendation, with a requirement that the intermediary highlights the relevant commission/inducement applicable to the recommended product. Information can be made available to people but it may not be looked at, despite its relevance. Therefore it is important to bring the relevant commission directly to the consumer's attention.

The proposal lacks clarity and detail in relation to whether the intermediary is required to disclose on the summary document the potential range of inducements it can take on particular products, e.g ARFs or Buy Out Bonds, from *each* provider or whether the disclosure can be of an *indicative* level of inducement from each or from one particular or typical provider. Bear in mind, in individual cases intermediaries may wish to take lower or higher inducements than an indicative level.

It would be preferable if the Central Bank prescribed the format and content of the summary document, so that consumers would be able to compare like with like from different intermediaries. Too much information and disclosure will overwhelm the consumer and make the inducements document of little value to the consumer. In terms of information that must be specifically drawn to the consumer's attention, it may only be necessary to show information only in relation to the type of product being sought, rather than overloading the consumer with information on e.g. mortgages when the consumer is interested in a personal retirement bond.

The proposal has the potential unintended consequences of reinforcing the risk of the market huddling around 'norm' commission terms for particular product types, so as to not appear to be out of line with competitors.

Consideration might also be given to imposing a similar disclosure of inducements requirement on insurers and providers, to summarise and disclose the range of inducement terms they currently pay to intermediaries and their own sales staff.

The proposal that firms be required to maintain records showing how the inducement summary is brought to the consumer's attention is a positive one from a governance perspective. There is the risk that it will simply be another box-ticking exercise without any real engagement behind it. One option might be to require the intermediary to provide the consumer with a page setting out the commission/inducement applicable to the product recommended, and commissions/inducements from comparable products, and (as suggested in our response to questions 14-16) requiring the consumer to explicitly consent to the selected level of commission on the application form.

Questions 27 to 29

The proposed definition of ''inducement" leaves ambiguity in relation to the deduction and payment by a provider of client mandated commissions/fees from pension arrangements, as to whether such payments fall within the proposed definition and hence within the provisions of the Code relating to inducements?

As outlined earlier, under individual pension policies the insurer typically deducts the intermediary commission € for € from the value of the policy; in effect the insurer is acting as a paying agent on behalf of the policyholder by remunerating the intermediary for the service provided by the intermediary to the policyholder from the policyholder's own money (i.e. the policy value) and not from the insurer's margins.

For example, if a consumer specifically mandates the insurer to pay 3% initial commission and 0.5% pa trail commission from his ARF policy to the intermediary and the insurer deducts and pays this to the intermediary, is this an 'inducement' provided by the insurer to the intermediary?

It can be argued that in this circumstance the insurer is simply acting as a paying agent acting on behalf of the policyholder, and hence these payments are excluded from the proposed definition of '*inducement'* being a fee/commission paid to the intermediary by a '*person acting on behalf of the consumer'*, i.e. by the insurer acting on an instruction from the consumer.

The proposed definition of 'minor non monetary benefits' is generic and leaves itself open to different interpretations, e.g.:

- '*capable'* of enhancing the quality of service provided to the consumer, is less prescriptive than 'shall' enhance the quality of service;
- '*of a scale and nature such that they could not be judged to impair compliance …'* is a subjective judgment.

The Pensions Council therefore feels it would be sensible to specifically list in the Code allowed minor non monetary benefits along the lines outlined in Schedule 5, paragraph 2(5) MIFID II Regulations. However even if such a specific list is used, confusion and different interpretations might still arise in relation to :

- what is 'hospitality of a *reasonable* de minimis value'?
- whether overseas conferences are included?
- Whether *'participation in'* includes the cost of travel to and out of pocket expense reimbursement related to the relevant event?

The insurance industry had a long history of insurer entertainment of intermediaries, sometimes at a lavish level and involving overseas travel, etc. This entertainment was designed to create a relationship between insurer and intermediary, which could in some cases impair the intermediary's duty to act in the best interest of the consumer, e.g. invitation to overseas 'seminars' would be conditional (usually on a verbal and informal basis) on the intermediary providing a certain minimum level of new business to the insurer over a specific period

The list of allowable minor non monetary benefits may therefore need to be more prescriptive than that outlined in Schedule 5, paragraph 2(5) MIFID II Regulations.

Without a very specific and detailed list of allowed minor non monetary benefits with monetary limits specified for some items (instead of the proposed generic definition of 'minor non monetary benefits' open to different interpretations), there is a risk that insurers will exploit the weaknesses of the proposed generic definition and reengage in a new entertainment 'arms race'. Past entertainment practices could once again become an established feature of the insurance marketplace; this could cause damage to some consumers and weaken the effectiveness of the Code's other provisions in relation to inducements generally, e.g. more intermediary remuneration could end up being paid 'in kind'.END

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