Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

March 2014

Feedback Statement on Consultation Process for CP 72

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1. Introduction

On 30 August, the Central Bank (the "Bank") published its Consultation on the *Handbook of Prudential Requirements for Authorised Advisors and Restricted Intermediaries* (the "Handbook"). The consultation period closed on 29 November. The aim of the Consultation (CP72) was to seek the views of stakeholders in relation to the Bank's proposals on key changes to the prudential requirements of certain industry practices and the re-categorisation of firms. The key proposals were as follows:

- *Reclassification of Authorised Advisors (AAs) and Restricted Intermediaries including Multi-Agency Intermediaries (MAIs):* proposed reclassification was 'Investment Product Intermediaries';

- *Minimum regulatory capital requirement:* proposed removing the minimum requirement of €10,000 for AAs, and instead all intermediaries authorised under the Investment Intermediary Act, 1995 (IIA) would maintain a positive capital balance. The €50,000 minimum capital requirement on intermediaries acting as 'product producers' (PP) would remain;

- *Solvency:* IIA firms would, at all times, be required to meet their obligations in full as they fell due and balance sheet assets must at all times exceed liabilities i.e. a positive net asset position must be maintained;

- *Goodwill and Other Intangibles:* would not be eligible for inclusion in the calculation of balance sheet assets for regulatory reporting purposes;

- *Perpetual Subordinated Loans:* Perpetual subordinated loans may be deducted from balance sheet liabilities for regulatory reporting purposes (five-year subordinated loans would be included in balance sheet liabilities);

- *Professional Indemnity Insurance (PII)* – proposed the introduction of a requirement for all IIA intermediaries to hold PII at the same level as applies to insurance intermediaries registered under the IMR[1];

- *Annual Return* – The requirement to submit an annual return, no later than six months after a firm's financial year-end reporting date would be included in the revised Handbook.

This document summarises the feedback we received to CP72 and sets out the approach that the Bank intends to take in the amended Handbook. It is intended to be read in conjunction with CP72 and makes reference to proposals and terms used in the original consultation document which can be found on the Central Bank's website.

Please note that this document is for information purposes only. This document does not constitute legal advice and should not be used as a substitute for such advice. It is the responsibility of the regulated entities to ensure compliance with the prudential requirements of their IIA authorisation.

[1] Currently an annual limit of €1.25m per claim and €1.85m in aggregate

2. Submissions

The Bank would like to thank the Irish Brokers Association (IBA) and Professional Insurance Brokers Association (PIBA) for their joint submission in relation to CP72. In general, there was an understanding of the direction that the Bank is taking in strengthening the prudential supervisory framework. The response to the consultation is available on our website at the following link.

The following are the main issues highlighted by the respondents in respect of the CP72 proposals:

1. Reclassification
2. Scope
3. Retention of Capital requirement on Product Producers (PPs)
4. Solvency and Goodwill
5. Online Annual Return

Details of the submission made in respect of these issues and the relevant conclusions following careful consideration of the submission are set out below.

3. Main Issues Highlighted

3.1 Reclassification

In the CP, we proposed that intermediaries authorised under the IIA would be categorised as 'investment product intermediaries', as set out in Section 25 of the IIA.

3.1.1 Submission

The submission agreed that a reclassification of AAs and Restricted Intermediaries was necessary, as research has shown that consumers are unfamiliar with these terms and with the term MAI. However, the term "Investment Product Intermediaries" referred to in the legislation was considered to be inappropriate due to the fact that some intermediaries authorised under the IIA also deal in insurance products. The reclassification of 'Insurance and Investment Intermediary' was put forward for consideration.

Our Response: Having considered the above suggestion, we believe that firms which provide services of reception and transmission of orders to product producers (other than insurance undertakings), as set out in Section 26(1A) of the IIA, and act as a deposit agent or deposit broker and provide investment advice in relation to these products should be classified as 'Investment Intermediaries'. IIA firms that **only** provide services to insurance undertakings under Section 26(1A)(h) and are registered under the IMR would be classified as 'insurance intermediaries'. If firms carry out more than one activity, they would be classified as 'Investment and Insurance intermediaries'.

Firms will have to disclose in their terms of business documentation, the level of service and advice being offered and on what basis such advice is provided – tied, fair analysis, not fair analysis/not tied.

3.2 Scope

The CP asked about the scope of the Handbook. Where a firm was already prudentially supervised by the Central Bank under another primary authorisation (excluding mortgage and insurance intermediary authorisations/registrations), the CP proposed that the firm would be excluded from the scope of the Handbook, if the primary authorisation held by these firms allowed for more intensive scrutiny than those applied to IIA firms.

3.2.1 Submission

The submission indicated agreement with this provision once the concept of "primary authorisation" was clarified.

Our Response: The concept of primary authorisation refers to firms that are subject to more stringent capital and reporting requirements under another authorisation held by the intermediary. For example, MiFID firms that also have an IIA authorisation are subject to regulatory capital requirements which would be in excess of those proposed under the revised Handbook. A primary authorisation exemption would not apply where the regulatory and reporting requirements under that authorisation were equal or lesser than those proposed under the revised Handbook. By way of example, an intermediary may also hold an authorisation as a Debt Management firm – the exemption would not apply in this case, as the prudential requirements for Debt Management firms are similar to the requirements for IIA intermediaries.

3.3 Retention of Capital requirement on PPs

The Bank proposed the removal of the minimum requirement of €10,000 and its replacement by a requirement that IIA firms must maintain a positive net asset position at all times (see section on Solvency). No change in the requirement on PPs was proposed – they would continue to have a minimum capital requirement of €50,000.

3.3.1 Submission

There was agreement regarding the requirement to maintain a positive net asset position. However, the submission proposed that a distinction be drawn between two types of PPs as follows:

1. Intermediaries who appoint other intermediaries for the purpose of distributing "protection policies" as defined in the Consumer Protection Code 2012; and
2. Intermediaries who distribute 'investment instruments' as defined by the IIA via sub-brokers.

The submission considered that only intermediaries, as per Category 2, should be subject to the capital requirement.

Our Response: The IIA legislation does not allow for such a distinction to be made. Therefore all PPs will be subject to a minimum capital requirement of €50,000.

3.4 Solvency and Goodwill

The Bank proposed that IIA intermediaries must at all times be in a position to meet their financial obligations in full as they fall due. IIA firms could have a positive net assets position but not be in a position to meet their debts and obligations as they fall due, as the intermediary's assets may not be sufficiently liquid to allow them to be converted into cash on time. Furthermore, balance sheet assets must at all times exceed liabilities i.e. IIA intermediaries must maintain a positive net asset position for regulatory purposes. There was agreement with this requirement, subject to the reconsideration of the treatment of goodwill proposed in the CP.

The Bank proposed that goodwill and other intangible assets be excluded from the calculation of a firm's balance sheet assets for regulatory reporting purposes, due to the illiquid nature of goodwill. This is common regulatory practice for all financial service providers regulated by the Central Bank and regarded as prudent practice for the treatment of intangible assets.

In recognition of the current difficult economic climate in which the sector is operating, it was proposed that a transitional period of five years be allowed for the small number of IIA firms affected, to write down any goodwill **currently** included in their calculation of a positive net asset position for regulatory reporting purposes.

3.4.1 Submission

The representative bodies did not agree with the proposal for the treatment of goodwill and set out their concerns regarding this change as follows:

a) The amount of goodwill included in the total assets of a firm is a quantifiable amount calculated by an independent auditor, and this figure takes into account tangible and quantifiable commissions payable in the future and having a readily ascertainable market value;
b) This change will also act as an impediment to market consolidation; and
c) Not allowing goodwill arising on non-life insurance business to be included in the calculation of total assets for regulatory capital purposes acts as an impediment to members in considering the purchase of other non-life businesses.

Our Response: The wisdom of a policy allowing the inclusion of goodwill and other intangibles in the calculation of a firm's balance sheet assets for regulatory reporting purposes, as set out in the current Handbook (issued in 2006), is no longer considered prudent given the changed economic environment. Weak household incomes and declining levels of disposable income put pressure on consumers' discretionary spending for investing in new savings/investment/pension products or maintaining existing policies.

While the auditor reviews the calculations and assumptions and gives an opinion on these, they would not be in a position to verify that the goodwill figure was correct. In addition, the value of goodwill can fluctuate unpredictably or become impaired when it becomes known in the market/media that a firm is experiencing difficulties due to the general economic environment.

While noting the views in the submission that mergers and acquisitions may strengthen regulated entities, the Central Bank considers it prudent, that the acquiring firm be sufficiently capitalised **before** purchasing another entity, without having to rely on the value of goodwill and intangible assets to maintain a positive net asset position after the acquisition.

With regard to goodwill on non-life insurance business, customers (particularly younger tech-savvy customers) are more likely to shop around on-line and are less likely to have an allegiance to any single provider. Under the current Handbook, goodwill on non-life insurance business is not allowed to be included in total assets for regulatory capital purposes, and the Central Bank does not consider it prudent to reverse this position in the revised Handbook.

The Central Bank's proposed treatment of goodwill and intangible assets in the calculation of balance sheet assets for regulatory reporting purposes is in line with the treatment of goodwill for other financial service providers, including other low impact firms like Debt Managers, many of whom are IIA firms. For the reasons outlined above, the Central Bank intends to implement the proposal set out in CP72.

Therefore, for firms that **currently** include goodwill (in their latest submitted annual return before 1 July 2014) in order to meet the requirement to maintain a positive net asset position for regulatory reporting purposes, the transitional arrangements will allow these firms until 2019 to write off their goodwill on a straight-line basis over five years with the first write off being included in their financial accounts from 1 January 2015 (annual return due to be submitted at end-July 2015).

3.5 The Online Annual Return

It was proposed that the requirement to submit an online Annual Return (AR) be imposed as a condition on the authorisation of IIA intermediaries and set out in the revised Handbook, in lieu of the requirement to submit annual audited accounts. IIA firms will continue to be required to prepare annual audited accounts under Section 33 (1) of the IIA and the Central Bank would retain the right to require firms to submit these accounts, if there were queries on their annual return.

3.5.1 Submission

The respondents agreed with the requirement to submit an online Annual Return. However, they objected to the requirement for non-cash handling IIA firms to be required to complete audited

accounts, while IMR firms engaged in similar activities were not subject to this requirement. They urged the Central Bank to seek legislative change to amend this requirement.

Our Response: The online Annual Return should include audited financial information in relation to IIA firms. The Central Bank regards the appointment of an auditor to audit an authorised IIA firm as a fundamental prudential supervisory tool and the Bank gives due regard to the auditor's statutory duty confirmation in relation to the on-going supervisory requirements for IIA firms.

4. Next Steps

The amended Handbook is expected to be available before end-April and will become effective as at 1 July 2014 with the exception of the following:

1. The transitional arrangement for the treatment of goodwill will only apply to firms that have included goodwill in the calculation of their regulatory capital in their **latest submitted** Annual Return, allowing these firms five years to reduce their goodwill for regulatory reporting requirements purposes. It is proposed that the first write off (80% of goodwill allowed for regulatory capital purposes) for these firms will be included in their financial accounts as at 1 January 2015, with their Annual Return due for submission by end-July 2015. This transitional arrangement will not be available to firms that do not submit an Annual Return prior to 1 July 2014.

2. The changes to the PII requirements will come into effect on 1 July 2014 for newly authorised IIA firms and IIA firms that currently do not have any PII in place. IIA firms that already have PII in place for their insurance intermediary activities under the EU (Insurance Mediation) Regulations, 2005 (IMR), will be required to ensure that their IIA activities are covered when their policy comes up for renewal on or after 1 July 2014. By 1 July 2015, all IIA firms should have PII in place to cover their IIA activities.

3. The date for the introduction of the reclassification will be discussed and agreed between the Central Bank and the Representative bodies, and will take into account any technical issues that may need to be addressed in relation to the Central Bank's Registers.

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