Submission by:

Brokers Ireland

on the

Joint Public Consultation Paper
Department of Finance and the Central Bank of Ireland

Funding the Cost of Financial Regulation 2015

Consultation Paper CP 95

This submission outlines the views of Brokers Ireland in relation to relevant proposals contained in the Joint Public Consultation Paper, Department of Finance and the Central Bank of Ireland - Funding the Cost of Financial Regulation 2015 (CP 95).

Brokers Ireland is a co-operative structure between the Irish Brokers Association (IBA) and the Professional Insurance Brokers Association (PIBA) who together represent over 90% of full time professional brokers in the Irish market, therefore representing the vast majority of full time regulated entities under category C.

We recognise that financial regulation is a necessary part of market supervision and consumer protection and that there are very significant costs associated with that activity. We welcome the opportunity to participate in this consultation process to record our concerns, views and opinions on the wide range of costs that Retail Intermediaries incur to ensure their customers are protected and the integrity of the market is not compromised.

Outlined below are responses to the questions posed in the consultation paper.

1. Any change from the current funding arrangement would have to have due regard for the competitiveness of the industry. Do you consider that there are any particular competitiveness issues to be taken into consideration in revising the funding approach? Please state clearly your reasons for any such issues, their quantification and suggestions on how they may be addressed.

Yes, we believe any change in the current funding arrangement will impact the competitiveness of the industry. Increased levies result in an increase in the cost of doing business. It is an additional expense for retail intermediaries who are very heavily levied already with five different costs contributing to the protection of the consumer. These include:

- Central Bank Industry Funding
- Financial Services Ombudsman
- Investor Compensation Company Limited
- Professional Indemnity Insurance
- Requirement for Audited Accounts for IIA authorised Retail Intermediaries

A move to full funding, thereby doubling the industry levy will cause a significant financial burden on intermediaries. Intermediaries have seen their levies increased substantially over the last 5 years coupled with increasing premiums for Professional Indemnity Insurance and levies to the Financial Services Ombudsman and ICCL. The effect of these increases is demonstrated by the number of Intermediaries which have left the industry since 2011. The closure of these brokerages (who are based throughout Ireland) has caused job losses in the sector and Brokers Ireland firmly believe that were the industry levy to move to a 100% funding, many more intermediaries will cease trading. It would not be in the interests of consumers for the intermediary sector to shrink, making access to independent advice harder to obtain. Brokers Ireland believe that the enhanced benefits to prices, investment returns, product innovation and service levels that the intermediary market brings justifies the maintenance of 50% funding for the intermediary sector. The decline in intermediary numbers would also lead to further funding deficits, putting more pressure on the remaining intermediaries.

As the number of retail intermediaries' contract, the choice for consumers is reduced and the presence of independent financial advisors in local communities is diminished. Consumers are likely to be forced to resort to nationally branded websites of direct providers or rely on banks, credit unions or post offices to provide guidance and advice. Such distribution channels do not offer impartial advice and cannot offer a choice of products or advise across the market. These channels have been shown to lack independence and the expertise necessary to deliver a broad range of products and services to meet customer needs.

It is worth mentioning that businesses that are not regulated in Ireland do not have to pay these charges. Companies who passport services into Ireland are regulated by the Central Bank for conduct of business rules but do not have to contribute to this cost. There is potential for this to be exploited where companies have access to the Irish market but do not incur any of the costs. These firms are regulated by the Central Bank for conduct of business rules but the cost of their regulation is absorbed by those who are authorised here.

Brokers ultimately seek fairness and transparency. They want to compete on a level playing field where their services are accessible to all customers. The APB (Approved Professional Body) system should be removed. This allows accountants to operate on an incidental basis without direct Central Bank regulation - it is inappropriate for firms providing the same products and services as intermediaries not to be subject to the same requirements. Removing this regime would create a level playing field amongst firms and would also mean more contributors to fund the intermediary unit.

The levy intermediaries pay represents a higher percentage of turnover than that which larger firms pay; for example, if the intermediary levy were to be doubled they would be paying an estimated 2.7% of their turnover on regulatory levies (the intermediary sector turnover estimated at €200m) as opposed to credit institutions which would be paying 0.42%1.

We believe that intermediaries funding requirements should mirror those of the Credit Union sector whose industry funding is limited to a 50% contribution. Both are small community based regulated entities, providing much needed employment and access to financial services for consumers throughout Ireland.

2. Any change from the current funding arrangement would have to have due regard to consumers and tax payers. Do you consider that there are any particular consumer or tax payer issues to be taken into consideration in revising the funding approach? Please state clearly your reasons for any such issues and suggestions on how they may be addressed.

Yes, we believe taxpayers should pay for financial regulation. It seems simplistic to present the option as an 'either/or' in relation to who pays - the taxpayer and/or the industry. Financial stability and consumer confidence is in everyone's interest so we suggest that all stakeholders should pay some proportion and the most equitable method of doing this is the current 50/50 model.

If industry funding increases to a 100% basis, both the retail intermediaries and the insurance undertakings are ultimately going to pass the cost back to the consumer which will simply mean increased costs to those who buy insurance. When insurers calculate premiums they build their costs into the premiums. Therefore, if the Central Bank passes the full cost of regulation over to the industry it is inevitable that the average premium will increase for consumers.

We believe an independent examination should take place to look at the effectiveness and efficiency of existing structures at the Central Bank of Ireland and the allocation of costs of the regulatory

---

[1] Page 11, Funding the Cost of Financial Regulation

system. Before any move to doubling the costs to the industry, there should be an elimination of all unnecessary and inefficient costs.

As an industry sector, we are extremely concerned at recent developments in the Central Bank leading to an immediate increase in 2015 levies. On one hand, there is the Joint Public Consultation Paper published by the Department of Finance and the Central Bank of Ireland to address Funding the Cost of Financial Regulation, and on the other hand without any opportunity for consultation, a series of industry briefings takes place to advise that an increase in industry funding is to take place to 'smooth volatility' in the Public Sector pension scheme arising from Financial Reporting Standards (FRS). (Copy of Central Bank's Commentary on 2015 levies attached). It is extraordinary that an industry sector that has systematically renegotiated the pension schemes of all of its employees should be called on to supplement the public sector pension costs. The additional levy requirement, being applied by the Central Bank to fund their pension costs is surely a conflict of interest. We urgently require the oversight of an Industry Board to represent the interest of the taxpayer and the industry in arriving at levies and other areas of regulatory governance.

3. Do you consider it appropriate for taxpayers to continue to fund a significant proportion of the cost of financial regulation activity? If you disagree, what would you propose instead?

Yes, Brokers Ireland considers it appropriate for consumers/taxpayers to continue to fund 50% of the cost of financial regulation activity.

Good regulation is for the benefit of both the consumer and the industry. Consumers benefit from the existence of the intermediary sector at both an individual and market level as competition between product providers to distribute through the Intermediary sector results in greater product innovation and price benefits which are to the benefit to consumers. The existence of the intermediary sector also allows consumers access to independent financial advice.

Research (PIBA and Standard Life – value of advice report) indicates that consumers who have access to independent financial advice:

- have nearly double the savings and investments than those who don't.
- are more than twice as likely to have a pension.
- are more financially protected as result of holding more financial products.
- feel more financially confident and also feel more confident about their financial future.

These results are consistent with earlier studies in the UK (The Value of Advice Report 2012 unbiased/Standard Life) and Australia (Value Proposition of Financial Networks 2011 KMPG/Econtech) and a CIRANO (a Québec based private non-profit research organization) report entitled Econometric models on the value of Advice of a Financial Advisor in July 2012 based on the Canadian market.

We believe that the increased competition provided by the intermediary market is an externality which is best paid for by tax subsidy rather than direct fees which may reduce competition.

Again, particularly in the context of the recent industry briefing, we do not believe the taxpayer should write a blank cheque for regulation with little or no input into how the money is spent. In this context we suggest an 'Industry Oversight Panel' representing all stakeholders.

4. Do you consider it appropriate that industry be required to fully fund the cost of financial regulation activity? If you disagree, what would you propose instead?

No. We believe that the status quo should prevail for at least the next five years. We see great merit in restoring an industry panel that would represent all stakeholders including the tax payer to oversee how the substantial costs of regulation are allocated; seek greater efficiencies and greater accountability in how services are delivered.

We believe that the Central Bank should now examine the remittance of fines and settlements to fund industry regulation. Previously in 2013 in a joint submission by the IBA and PIBA on the Consultation on Impact Based Levies and Other Levy Related Matters CP 61, we had outlined that in order to avoid a conflict of interest, monetary penalties should be remitted to the Exchequer rather than to the Central Bank directly, however in order to raise funding required we feel that this would be an appropriate alternative than a move to 100% funding.

5. Do you consider it appropriate that a move to full funding should commence in 2016? If you disagree, what would you propose instead?

No. We disagree with this proposition at the present time. Since 2010, we have seen the industry levy rise every year through a period of general economic recession culminating in the 40% + uplift required in 2015. We believe any change to the funding model should be introduced on a phased basis, after looking at other methods of funding, apart from an across the board levy as applies presently.
For Example; an industry panel should be established and their remit should include:

- Examine the levy and review annually
- Consider contributions from settlements & fines (Currently returned to the exchequer)
- Review and consider reallocation, wholly or in part, of 5% levy payable by consumers at the moment attributable to PMPA , ICI & Quinn
- Continue a lesser contribution from the exchequer
- Carry out an impact analysis of the proposed change from 50% to 100% funding. The findings should be shared with the industry before moving to 100% funding, which would be a 100% increase in the industry contribution. If the increases included in the industry briefing are signed off by the Minister for Finance, the resulting increases following 100% funding will imply that levies will treble over 2 years.
- Consider ways to enable the Credit Unions to pay in proportion to their exposure
- Obtain greater contribution from professional bodies who operate in the same space but have very little independent consumer protection
- Examine how a change in industry funding will impact on the contribution to the FSO that is currently set at a percentage on the industry contribution
- Look at the layers of Consumer Protection that exist already, identify where they overlap and reallocate the existing payments to avoid duplication.
  - Professional Indemnity Insurance
  - The requirement for audited accounts from all entities regulated under IIA
  - Contribution to the Investor Compensation Scheme
  - Contribution to FSO
  - Industry Funding.
- Ensure that decisions made by the Central Bank provide value for money to all the stakeholders.

6. Do you consider it appropriate that a move to full funding should take place in a single step in 2016? If you disagree, what would you propose instead?

No. Brokers Ireland does not agree with any move to full funding by the industry.

7. Do you consider it appropriate that any revision in the proportion of funding provided by industry should continue to apply uniformly across all industry funding categories? If you disagree, what would you propose instead?

No. Brokers Ireland disagrees; uniform application suggests a move to a 'one size fits all' approach in each industry sector. The risks associated with the intermediary sector are limited and recognised to be low impact– this should be reflected in the level of supervision that the sector undergoes by the Central Bank. Intermediaries do not hold client monies and all premiums received by Intermediaries are protected by the insurer (S16 IMR & 25g IIA) so the risk of loss of client monies is minimal. Brokers are community based entities facilitating informed choice, access to advice by consumers and enhancing competition between financial service providers.

8. Do you consider that there are any particular industry funding categories which warrant a derogation or alternative funding approach? Please state clearly your reasons for such a view.

Yes, intermediaries by their nature are small to medium sized firms and we believe they should be treated the same as the Credit Union sector with a maximum requirement of 50% funding.

The recent increases in levies have already caused intermediary numbers to shrink, if this trend were to continue it would mean that the remaining intermediaries will have an increased burden.

We understand that a large proportion of regulatory costs are fixed overhead costs (IT, HR and other central services) and that the direct or marginal costs of regulating a particular sector may be substantially lower than the total assigned cost. It is not appropriate that the imposition of a full levy reflecting the fixed costs of running the Central Bank is applied, if this leads to a substantial number of intermediaries exiting the industry.

Assurances are required that the cost of the regulation of the intermediary sector will be scaled to the numbers of Intermediaries in the industry.

In the interest of market stability and consumer protection, we believe that anyone who provides financial advice services or products in Ireland should contribute to the regulatory process. Brokers Ireland urges for the removal of the Approved Professional Body regime, these firms should be brought within the intermediary sector. Removing this regime would create a level playing field amongst firms and would also mean more contributors to fund the intermediary unit.

Brokers Ireland has major concerns with regard to the lack of transparency of the calculation of the current levy. We would urge that the Central Bank revert to the calculation of levies based on turnover, this is the preferred approach by intermediaries and we feel it is a more equitable way for calculation of a levy. We continue to believe that a turnover band structure is the most transparent and fair method for determining fees to be applied on the intermediary sector. The disappearance of the small retail intermediary is not in the best interest of the local community or the future protection of an aging population. The role of the small trusted advisor, providing advice and access to cover, in a locality should not be underestimated.

We believe that making sure that every entity that operates in this industry sector should contribute but that certain low impact operators should not be included in any increased contributions.

9. Are there any other considerations that you think should be taken into account in seeking to come to a decision on a move to full industry funding? If so, what are they?

Overall, we agree that the Industry should contribute to the cost of financial regulation but that there are severe flaws in the existing model particularly in relation to transparency and accountability. We believe that requesting small to medium sized Brokers to contribute fully may be counterproductive. It should be borne in mind that the doubling on the levy will affect the viability of intermediaries and in turn will have a knock on effect on employment within the intermediary sector. As outlined above in a previous response, it is also in consumers' best interest to have access to independent advice via the Intermediary sector and to stimulate competition between providers.

There continues to be a significant portion of intermediaries who do not pay their annual levy, this increases the financial burden on the intermediaries who are paying their fees as they are subsiding non-payers. This issue should be addressed before any decision to move to a full funding model is made - the method of revocation of these intermediaries' authorisations needs to be a more efficient and speedier process.

In summary,

- We believe **all** increases in levies should be frozen until the 2015 levies have been independently reviewed in the light of recent industry briefings.

- We consider that it is incumbent on the Central Bank to revive the Industry Panel made up of interested stakeholders to examine all the issues associated with the industry levy, instead of reverting to the hard pressed small to medium sized brokers. We would strongly urge the Central Bank to consider other possible alternatives.

- Brokers Ireland urges for the removal of the APB regime, these firms should be brought within the intermediary sector. Removing this regime would create a level playing field amongst firms and would also mean more contributors to fund the intermediary unit.

- Firms that Passport their services into Ireland operate with a competitive advantage over companies that are fully regulated entities in Ireland. We suggest this should be reviewed and a contribution from these entities towards the cost of the conduct of business oversight should be considered.

- Brokers Ireland is very concerned at the position adopted by the Central Bank in relation to 2015 industry levies. We believe this consultation has been grossly undermined by the imposition of substantial increases to the2015 levies to address the revaluation, mandated under Financial Reporting Standards (FRS) to support Central Bank pensions. This revaluation is not peculiar to the Financial Regulation division of the Central Bank. We believe this shortfall should be addressed as a wider issue of public sector remuneration. We consider that a conflict of interest exists and a remedy should be provided to restore confidence on Central Bank governance.

CENTRAL BANK GENERAL COMMENTARY on 2015 Levies

Overall there has been an increase of £20.6 million in the 2015 Industry Funding levy (from (51.1 million in 2014 - excluding the supplementary levies for credit institutions - to £71.7 million) which results in significant increases in many levy rates.

Key factors impacting on the 2015 Industry Funding Levy are as follows:

1. The 2015 Budget for financial regulation activity totals €137.4 million, and reflects an increase of €14.4 million from €123.0 in Budget 2014, and a slight reduction compared with the 2014 outturn off €39.4 million.

2. 2015 pension cost of £29.0 million related to financial regulation is the most significant driver of the 2015 increase (2014 Budget: €13.4 million; Actual: €17.6 million). Pension costs in the accounts reflect an approach mandated under Financial Reporting Standards ("FRS") which, in the current low bond yield environment, gives rise to high charges. While consideration has been given to finding an alternative approach for levy purposes to smooth the volatility arising from the FRS, the conclusion has been to maintain the established link between the accounting treatment and the levy calculations.

3. A shortfall in levies from prior years of £2.4 million adds to the cost to be recouped from Industry in 2015 (31 December 2013: Surplus €4.8m). Unpaid levies represent €1.7m of this €2.4m shortfall. In prior years, such unpaid levies were recouped from the industry category to which they related. For 2015, it is proposed to redistribute unpaid levies over all categories in proportion to each category's share of levies before redistribution. This approach avoids the paradox whereby failure to pay the levy benefits the delinquent firm and also imposes the costs it has avoided on its direct competitors.