

October 2016

Central Bank of Ireland Discussion paper on the Payment of Commission to Intermediaries

Submission in response by AA Ireland.

Introduction:

The AA is Ireland's motoring organisation. It has acted as a lobbyist for motoring interests and in a leadership role supporting the consumer rights and interests of the motorist for over 100 years. It is active in areas as diverse as road safety, progressive transport policies, motoring costs and taxation.

It has also grown to become the largest personal lines insurance intermediary in Ireland providing Motor, Home, Travel and recently Life insurance. The AA has over 120,000 motor insurance customers and deals with a panel of three underwriters to provide them with quality motor policies. The AA also provides Home Insurance (circa 60,000 policies) and Travel Insurance (circa 65,000 policies) via tied arrangements with specific underwriters. The AA has also begun to offer Life & Mortgage Protection Insurance, again as an intermediary via a tied arrangement with one underwriter, although this is currently for a very small number of customers.

The AA would call the Central Bank's attention to the very significant difference for the consumer between products like Home & Motor Insurance versus investment products that entail long-term commitments.

The AA was a mutual organisation for most of its history. It demutualised in 1999 and was part of AA plc when that group became a stock-market listed company in 2014. In 2016 AA Ireland separated from AA PLC to become a stand-alone entity.

The AA's position is unique and leaves it very well placed to see differing points of view in the ongoing issue of consumer protection, value, transparency and fair treatment.

The Central Bank in embarking on this process is primarily concerned with the protection of the consumers' interests. Any consumer of financial services is entitled to believe that the seller, whether an intermediary, a broker or a supplier directly, is acting in good faith and is being fair and honest. Any services or products offered to the consumer must be offered on an impartial basis; sellers should not attempt to influence the consumer in ways that vary depending on commission or payment arrangements which the consumer cannot see.

These are important general principles with which no responsible seller disagrees. They are fully supported by the AA.

What does the consumer want?

The AA sells general insurance products along with Life and Mortgage Protection cover. It does not sell pensions or savings and investments products.

In this market consumer needs vary by the type of product. For general insurance, as opposed to financial products, most policies are an annual purchase and are thereby only considered prior to renewal each year. Therefore it is important to provide consumers with sufficient information to allow them make the decision that suits their needs and budget.

Consumers have a range of choices. They can readily obtain prices and product alternatives from brokers and direct insurers, from websites, over the phone or in person.

When a customer is renewing their policy they must receive their notification at least 15 days prior to expiry of cover. This allows them the opportunity to shop around, using the various channels to their advantage. They can obtain as many prices as they wish without cost or obligation before making their decision. In the AA's case, 75% of quotes for motor insurance are received via the website; of those, only 5% complete the purchase online. This implies that a lot of consumers use the AA website to sense-check their premium as part of the shopping around process. We presume other providers have a similar experience.

When a consumer pays an insurance premium their primary concern is that the product is good value and is suitable to their needs. There must be a clear understanding of what the product is, what are its features and limitations, how it compares to other products and how it will meet expectations.

For Motor Insurance consumers are price conscious and tend to shop around. In the AA's experience typical motorists will challenge insurance renewal prices and are very aware of prices. This has come strongly to the fore in the last 2-3 years because of a general rise in the level of premiums.

An AA poll conducted in March 2016¹ showed that over 92% of motorists considered the cost of their motor insurance to be 'very important'; higher than fuel costs, motoring taxes or road safety.

Existing protections are strong

The existing Consumer Protection Code obliges intermediaries to act in the best interests of the customer. Regulation is strong and detailed; intermediaries generally interact quite frequently with the Regulator and are familiar with audits and assessments. The principles and details of the Consumer Protection Code are well understood.

In the AA's case there is a dedicated Compliance Department. There is regular training & continual professional development. All calls are recorded for permanent storage and all staff receive regular assessment and are monitored for call compliance and call quality.

All customer facing staff who sell insurance products must become APA (approved product advisor). All supervisory staff must be CIP (certified insurance practitioner) qualified.

Complaints and breaches are taken very seriously internally, and any customer complaints that arise are managed through a detailed and documented complaints process which is aligned with the principles of the Consumer Protection Code.

Choice & Paths to Market

It is in the consumers' interest for there to be choice available and a genuinely competitive market. Intermediaries provide choice for the consumer.

The AA is concerned that competition in the motor insurance market is weakening. A number of direct players have reduced their exposure, narrowed their footprint, withdrawn from Ireland or failed altogether.

Zenith Insurance has stopped trading in Ireland. Some insurers have limited their acceptance of new business and have ceased offering products to some cohorts. Others have closed branches in locations nationwide. Insurers are tightening their acceptance criteria and are less likely to provide cover for non-standard risks, for example for consumers with older cars, unusual requirements or high claims experience. Setanta insurance failed altogether in 2014; Enterprise Insurance did the same in July of this year.

All of this has the effect of reducing competition and choice for the consumer. Brokers and intermediaries play a very important role in this context by providing choice and facilitating competition.

For the Irish Insurance market to be healthy it needs to attract new insurers.

Any potential new insurer looking to trade in Ireland faces costs and barriers that are considerable. For a start-up operation to attract new business, significant investment would be required in areas such as IT, HR and Marketing. Another key success factor is local market knowledge. Assessing risks and understanding the Irish market in detail requires a depth of experience and knowledge that a new insurer would take time to gain. Brokers and intermediaries help to bridge this gap. They are therefore a very important channel to market to allow new insurers to enter the Irish market.

It is clearly in the consumers' interest for brokers and intermediaries to be actively involved in the provision of Motor insurance. Their presence broadens competition, facilitates market access and provides choice.

Personal Lines & General Insurance vs Long Term Products

As noted above, there is a significant difference between products like Home & Motor Insurance which are 1-year products for a specific purpose where the buyer is not at risk of financial loss versus investment products that entail long-term commitments.

By far the largest part of the AA's activity in the Insurance area relates to the sale of Motor, Home and Travel policies.

Motorists can and do change insurer every year and there is strong evidence that buyers generally are very price aware and value aware. There is no evidence that the consumer lacks information or is being channelled into making bad choices. Quite the reverse. Research carried out by Millward Brown² from 2013 to 2015 shows that 60% of purchasers of motor

insurance shop around with around half of those switching supplier, and many others negotiating with their existing supplier for a better deal.

Home Insurance consumers are traditionally somewhat less price aware and somewhat less likely to change or review their policy annually. This is likely to be because it is a simpler product and tends to be less costly overall. This is evidenced by traditionally higher retention rates compared to Motor Insurance. Travel Insurance is often bought *ad hoc*, trip by trip. There are consumers who choose annual travel insurance products but again they tend to be aware of competition and they tend to shop around on renewal.

1. In your view, what aspects of how intermediaries are paid commission work well to deliver responsible business conduct, fair treatment of consumers and avoidance of conflicts of interests when consumers are sold financial products?
2. In your view, what aspects of how intermediaries are paid commission do not succeed in delivering responsible business conduct, fair treatment of consumers and avoidance of conflicts of interests when consumers are sold financial products or present particular risks in this regard?
3. In your view, are there any changes needed to commission arrangements in Ireland, regulatory or otherwise, to do more to encourage responsible business conduct, fair treatment of consumers and avoidance of conflicts of interests when consumers are sold financial products?

Policies and products sold through intermediaries are well regulated under the Consumer Protection Code as noted above.

As an intermediary the AA provides a more complicated and complete service than simply selling a policy. It adds value to the underwriter and to the consumer in several ways. Intermediaries handle many important aspects of the transaction including issuing documentation, recording and keeping of all relevant records such as letters, emails and phone conversations, handling of transaction costs, collection of payments etc. Staff must be qualified and supervised and all of these aspects are subject to regular audit.

Each of these activities, from advertising to call handling to administration of calls and documents to data protection, is subject to detailed regulation.

The AA has a strong culture of regulatory awareness. In addition it engages with bodies like the Insurance Institute and the Irish Broker's Association which run regular seminars, workshops and training courses centred on the themes of compliance, regulation and its importance.

Intermediaries save an underwriter considerable expense in their dealings with the customer. These include Marketing, where an intermediary saves cost by bringing the customer to the provider, and a whole range of administrative costs before, during and after a sale has occurred.

Intermediaries are in a position to negotiate rates with underwriters that reflect this contribution to the value chain. The effect of this is frequently that the intermediary is able to

offer the customer very good value and often prices that are cheaper than would be the case dealing with the underwriter directly. Hence looking just at 'commission' as if it were a stand-alone expense to be added to the cost is misleading.

For the customer, the presence of intermediaries offers choice and competition.

Considering the volumes of products sold through intermediaries and renewed through those same channels every year it is reasonable to observe that the levels of customer satisfaction with the value provided are reasonably high. The AA is very familiar with the Regulator and with audits and checks and is satisfied that the sector is tightly monitored.

The imperative is to guard against unfair commissions or those that are unbalanced and therefore affect the impartiality of the intermediary. For general insurance the AA is not aware of any evidence to suggest that this is a concern.

4. Are there other features or types of commission arrangements that the Central Bank should take into account in considering this topic?
5. Are there practices or features of commission arrangements in other jurisdictions to which you think the Central Bank should have regard to?
6. Are there any changes to these practices which you consider necessary or appropriate to better promote responsible business conduct, fair treatment of consumers and avoidance of conflicts of interests when consumers are sold financial products

Commission is only paid when a sale is completed. Consumers can engage with the intermediary by checking their website and/or call centre, getting comparative quotes etc without obligation. The consumer does not have to make any form of up-front payment to the intermediary and in fact is normally paying the underwriter via the intermediary, who in turn awaits payment of commission back from the underwriter in due course.

In the entire transaction the intermediary remains bound by the Consumer Protection Code and must:

- Avoid conflict of interest
- Act in the customer's best interest
- Sell only suitable products
- Meet competency requirements
- Handle complaints in the prescribed way

7. Are there features of the current consumer protection framework that you would highlight as strengths in the context of commissions specifically?
8. Are there weaknesses or gaps in the current consumer protection framework in the context of commissions specifically?
9. Do you have any other observations on the current domestic framework as it relates to the practice of paying commissions in Ireland?

We believe that the current Consumer Protection Code is strong and is well enforced. There is evidence to show that in areas related to general insurance the consumer tends to be well informed and empowered. This is shown by how frequently consumers shop around and the tendency to challenge insurers on value before renewal.

Intermediaries are required to be very transparent. There are clear rules around appropriate selling, frequency of communication, timely issuing of renewal documents and a range of other measures. Intermediaries in Ireland tend to be either local brokers embedded in local communities countrywide, or large national brands like the AA. For each there is considerable risk of reputational damage arising from non-compliance or regulatory breaches.

Rates of commission are often expressed as percentages of revenue or of the cost paid over to the underwriter. In the case of general insurance or personal lines these tend to be far lower than in the case of more involved, detailed and long term products like pensions and investments.

Commission is the primary source of income which allows intermediaries to cover their costs and conduct their activity. That activity is not limited to the sale itself, it also includes functions like IT, Training and other requirements for the end-to-end service to the customer.

Intermediary resources add considerable value into the value chain which can be passed on to consumers, as well as offering choice and competition. If an intermediary was required to reveal its commission to others it would be of no advantage to the consumer who is focused on the final price. However it would compel the intermediary to disclose its arrangements to competitors. This weakens the position of intermediaries and favours underwriters without any gain for the consumer.

10. Do you have any general views on the potential benefits to consumers of properly designed commission structures outlined in this section?
11. Are you aware of any additional potential benefits to consumers? If so, please describe them.
12. Have you observed any of these potential benefits? If so, please provide examples and describe the kind of benefit that has accrued.
13. Would you weight any of these potential benefits over others as requiring special consideration or attention, and if so why?
14. Do you have any suggestions as to how the current regulatory framework could be improved or changed so as to enhance the potential benefits to consumers that arise from the payment of commissions to intermediaries so as to better promote responsible business conduct, fair treatment of consumers and avoidance of conflicts of interest when consumers are sold financial products?

A benefit of the current structure is that it allows intermediaries to add value and offer choice. This is particularly important for the provision of motor insurance at the moment in light of pressures on competition and rising premiums.

On the face of it Ireland should be an attractive market for new entrants right now as it would benefit from high premiums without the legacy back-book of developing claims. However any new player would need depth of local trading knowledge and market familiarity. These in effect make for a substantial entry barrier against new entrants and the only effective way to overcome it is to trade via intermediaries.

- | |
|--|
| <p>15. Do you have any general views on the potential risks to consumers of commission structures outlined in this section?</p> <p>16. Do you consider the potential risks to be accurately described? If not, please explain why.</p> |
|--|

When an underwriter sells or renews a motor insurance policy to a customer they must first arrive at a price to quote. They will do so based on a host of calculations and costs. These include underwriting, reserving, administration, marketing, etc. Out of all of these calculations comes a single laconic number that often appears entirely arbitrary to the consumer.

The consumer then considers that number against others available for a similar policy from other providers, insurers and intermediaries alike. The customer frequently does not draw a distinction between them, nor do they need to. If buying an annual motor insurance policy the priority is to get good cover at the right price.

As noted above, an intermediary can frequently handle many aspects of the value chain more effectively than an underwriter and within that added value can secure remuneration for itself in the form of commission while still offering a price to the customer that is cheaper than dealing directly or at least is certainly a competitive offer. This is healthy from the consumers' point of view.

If intermediaries were made to declare commission it would create an imbalance. Unless the underwriter was similarly required to outline all of its costs, and which portion of its quoted price related to which cost element, it would create a false impression that the intermediary is simply taking a cut without adding value. This would be unfair on the intermediary and bad for competition in the long run.

- | |
|--|
| <p>17. Are you aware of any additional potential risks to consumers? If so, please describe them.</p> <p>18. Have you observed any of these potential risks at play? If so, please provide examples and describe the impact of the risk?</p> <p>19. Would you weight any of these potential risks over others as requiring special consideration or attention, and if so why?</p> <p>20. Do you have any suggestions as to how the current regulatory framework could be improved or changed so as to better manage the potential risks to consumers that arise from the payment of commissions to intermediaries?</p> |
|--|

We are not aware of any additional risks to consumers arising from the current commission structure.

Generally speaking the AA believes that intermediaries in General and Personal Lines insurance offer a stimulus to competition and a service to consumers that is vital. Their presence guards

against direct insurers becoming too dominant and facilitates a generally healthy market when viewed in terms of competition and consumer protection.

We are not aware of any strong evidence to indicate that the consumer wants, needs or would benefit from changes to the way in which commission is declared or paid. As noted above, commission is the mechanism by which intermediaries are rewarded for the value that they add. At the same time the presence of intermediaries provides for that choice and also removes entry barriers for new competitive players looking to trade in Ireland.

The consumer is interested in the final price and quality of their insurance regardless of whether it comes from an underwriter or by an intermediary, provided that there is real choice.

The AA represents motorists and its priority is to ensure that they are treated fairly. As the industry continues to evolve there needs to be continued engagement between the regulatory authorities, the insurers and intermediaries. Most importantly the consumer also needs a strong voice. The current regulatory framework has served the consumer well but it cannot be assumed that this will always be the case. The regulation of the sector needs to be resourced and periodically reviewed in light of changes to the Insurance market.

Ends

1: *Extract from AA Motorists' Panel Poll March 2016.*

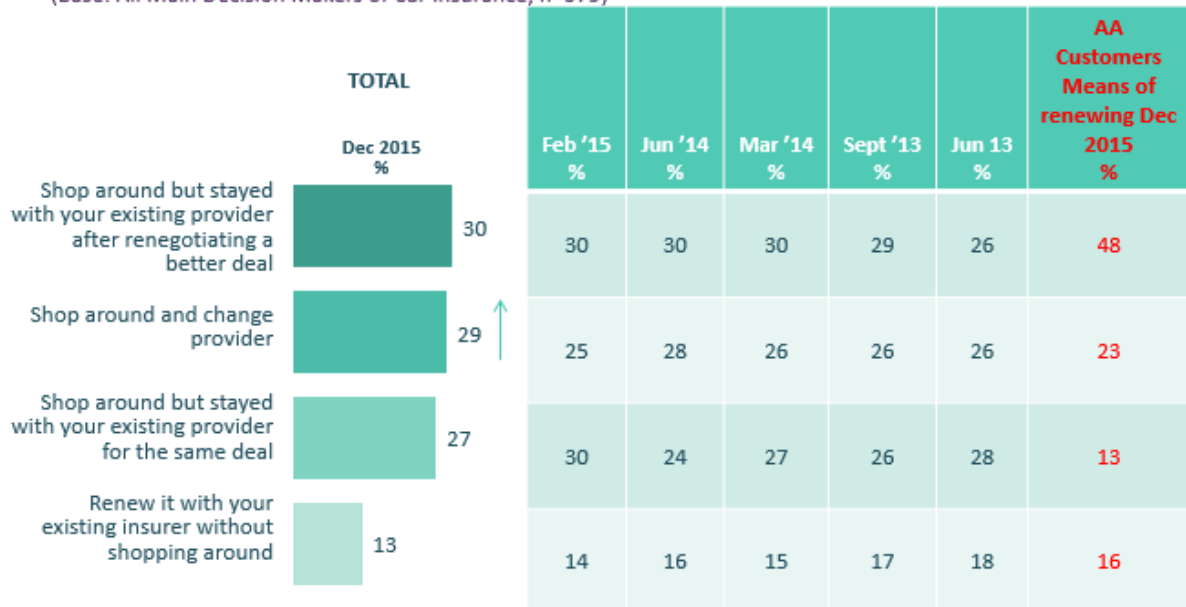
Q: Please indicate below how important you personally consider the following motoring issues to be in 2016.

	Very important	Somewhat important	Neutral	Not very important	Not at all important	Total
The cost of petrol & diesel	68.18% 6,013	25.47% 2,246	4.71% 415	1.28% 113	0.36% 32	8,819
The rate of motor tax	71.77% 6,308	22.60% 1,986	4.33% 381	0.98% 86	0.32% 28	8,789
The cost of motor insurance	92.35% 8,171	6.43% 569	0.95% 84	0.15% 13	0.12% 11	8,848
Vehicle registration tax	40.07% 3,495	31.83% 2,776	20.95% 1,827	5.09% 444	2.06% 180	8,722
Road safety	87.01% 7,620	9.60% 841	2.88% 252	0.35% 31	0.16% 14	8,758
Traffic congestion	45.89% 4,004	39.64% 3,459	12.03% 1,050	2.03% 177	0.41% 36	8,726
Garda presence / level of Garda activity on roads	50.03% 4,395	33.53% 2,945	13.07% 1,148	2.60% 228	0.77% 68	8,784
Repairing damaged roads (e.g. potholes)	77.12% 6,803	19.09% 1,684	3.14% 277	0.51% 45	0.14% 12	8,821
Constructing new roads	33.22% 2,903	42.01% 3,672	19.32% 1,689	4.50% 393	0.95% 83	8,740
Providing / improving cycle facilities	31.96% 2,795	31.56% 2,760	24.28% 2,123	7.51% 657	4.68% 409	8,744
Constructing new rail infrastructure (i.e. Irish Rail, Luas)	35.70% 3,133	33.77% 2,963	21.65% 1,900	6.17% 541	2.71% 238	8,775
Providing improved public transport resources	48.95% 4,301	32.37% 2,844	13.65% 1,199	3.30% 290	1.74% 153	8,787

2: Car Insurance: Shopping around behaviour (data: Millward Brown June 2013 – Feb 2015)

Shopping Around Behaviour

(Base: All Main Decision Makers of Car Insurance; n=379)



Nearly 60% of car insurance owners are shopping around with half of these switching supplier – the remainder renegotiated with their current provider for a better deal. AA customers are significantly more likely to stay with the brand after re-negotiating a deal.



(Q 8)

Note: Data shown for June 2013 – Feb 2015 sourced from Millward Brown