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Association of Expert Mortgage Advisors

Discussion Paper on the Payment of Commission to Intermediaries.

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This document has been compiled by the Association of Expert Mortgage Advisors in response to the Discussion Paper on the Payment of Commission to Intermediaries issued by The Central Bank.

The Association of Expert Mortgage Advisors represents a group of Financial Advisers who specialise in the provision of mortgage advice. Our experienced and qualified members have practical and direct experience in assisting borrowers on a daily basis in obtaining the mortgage most suitable to their individual needs and requirements. Our members promote professional standards and are well regarded by both their clients and the lenders they transact business with. We strive to develop long-term relationships with our customers who, in turn, can rely on our independent advice in all aspects of their mortgage requirements, based on our substantial experience, expertise and knowledge. According to independent market sources, we currently account for approximately 50% of all residential mortgage loans arranged by intermediaries.

Financial products and services play an extremely important part in the everyday lives of consumers. Intermediaries earn a sum of money ("commission") for arranging the sale of these products. When sold properly they deliver significant benefits to consumers. Responsible business conduct, fair treatment of consumers and the avoidance of conflicts of interest are essential aspects of any product sale, particularly those which involve the payment of commission.

This paper is largely drafted in the context of mortgages and the payment of commission resulting from the sale of mortgage and related products.

It should be noted that mortgage commission payable by product providers to credit intermediaries is flat at 1%. Some lenders apply clawback over a 3 year period where the loan is discharged in full. Intermediaries work under a strict compliance focused regime and have a high level of competency requirements (CPD). Currently there is no differential in pricing if a customer goes direct to a lender or deals with an intermediary. There is historical evidence in other jurisdictions that where fees are charged a large cohort of consumers do not seek advice, leading to an advice gap and as a result of this consumers often do not get the product most suited to their needs. There is historical evidence of institutional mis-selling in other jurisdictions. This is not reflected in the Irish market.

A number of product providers distribute their products exclusively through intermediaries and in some instances product providers have closed their own direct distribution channels to focus on the intermediary channel. The existence of intermediaries facilitates the entry of new product providers, competition and ultimately more choice for the consumer. However, choice without advice is useless.

Intermediaries spend a significant amount of time working on behalf of consumers and product providers where ultimately no sale occurs and therefore no commission is generated. Regulated intermediaries have significant costs including increasing but welcomed regulation. The majority of intermediaries rely on the premise of referral business to engage with new customers, this is reflected through the quality of advice provided on an on-going basis to consumers.

In considering the subject matter of this paper we believe there are a number of key points to be reviewed. These include:

1. Access to the most suitable advice for consumers
2. The practical application of the applicable regulatory framework
3. Relative ease of access for new entrants to the market ensuring competition and choice
4. The same rules applying for all channels of distribution

Any review of the current remuneration structure must that note of the fact that the current practice of remunerating the intermediary for the provision of financial advice largely works well and the incidence of financial product mis-selling which have been a feature in other jurisdictions has not occurred in this market. In addition it is essential that all stakeholders accept that they have a responsibility to work together in order to ensure that the best interest of the consumer is met at all times as required under the Consumer Protection Code.

The intermediary plays an integral role in the provision of financial advice to the consumer. This is reflected in both their market share and in the fact that a number of product producers choose to distribute their products exclusively via the intermediary channel. A number of product providers have or are currently closing down a number of branch and regional offices. The intermediary has a largely countrywide presence and therefore their existence is key to the consumer and the current remuneration model is essential to their business turnover.

In response to the Discussion Paper on the Payment of Commission to Intermediaries we wish to respond to the questions raised as follows.

Q1 – What aspects of how intermediaries are paid commission work well to deliver responsible business conduct, fair treatment of customers and avoidance of conflict of interests when consumers are sold financial products?

We believe the following aspects of how intermediaries are paid commission work well to deliver responsible business conduct, fair treatment of customers and avoidance of conflict of interests when consumers are sold financial products.

- Where a flat level of commission exists e.g. the mortgage industry this ensures no producer bias.
- The existence of a commission based remuneration model as opposed to fee based ensures an all-inclusive market based advisory service.
- The existence of clawback ensures the client is given appropriate initial advice.
- It lowers the distribution cost of distributors.
- It facilitates new market entrants which in turn encourages competition and better choice for consumers.
- Commission is only paid when the transaction is complete.

Q2 – What aspect of how intermediaries are paid commission do not succeed in delivering responsible business conduct, fair treatment of consumers and avoidance of conflicts of interest when consumers are sold financial products, or present particular risks in that regard?

There is nothing to suggest that the manner in which intermediaries are paid commission does not succeed in delivering responsible business conduct, fair treatment of consumers and avoidance of conflicts of interest when consumers are sold financial products, nor present particular risks in that regard. If there was it would be evidenced by a high level of complaints to the Financial Services Ombudsman. The existing compliance framework requires intermediaries to identify, monitor and control potential risks to consumers.

Q3 - 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?

Responsible business conduct is governed under the current Consumer Protection Code through a firm's Terms of Business which ensures that consumers are made fully aware of the remuneration received by the intermediary. This ensures and encourages responsible business conduct, fair treatment of consumers and avoidance of conflicts of interests when consumers are sold financial products.

Q4 – Are there other features or types of commission arrangements that the CBI should take into account in considering this topic?

We believe that all commission arrangements should reflect the long term nature of the product and ongoing advice required. Examples would include trail and renewal commission.

Q5 – Are there practices or features of commission arrangements in other jurisdictions to which you think the Central Bank should have regard to?

We engaged with fellow intermediaries in other jurisdictions and note the following in relation to the remuneration of mortgage intermediaries and wish to bring it to the attention of the Central Bank.

GERMANY

We understand that in Germany mortgage intermediary commissions are similar to Ireland in that 1% is more or less standard. Following a legislative review, the intermediary is allowed to take an upfront fee instead of a commission, but not both together. This is a rare occurrence as consumers do not favour paying a fee.

In terms of regulation, new legislation which was introduced in 2010 made it obligatory for an intermediary to outline to the consumer the commission payment. Additionally, some banks began to write the commission payment into their customer contracts.

AUSTRALIA

We understand that Australian mortgage intermediaries receive up front commissions around 0.5 - 0.6% and a trail commission of around 0.15% on the reducing balance for the term of the loan. (The average loan lasts for about 4 years).
In 2014 the Government established an Inquiry into the nation's finance system (the Murray Inquiry). One of its recommendations was that the Government should review commissions paid to intermediaries with specific reference to the influence that commissions had on the sale of mortgage products.

This year ASIC (Australian Securities and Investments Commission) established a review into intermediary commissions and this is currently underway and due to report later this year. Initial indications are that it is unlikely that commissions will be removed. However ASIC is keen to ensure that commissions paid do not create provide bias.

HOLLAND

We understand that since 2013 mortgage commissions are prohibited by law. This is a result of product provider bias and light regulation. The intermediary is paid a fee by the consumer. Mortgage Lenders who provide advice also have to charge the consumer the same fee ensuring a level playing field. The Dutch Financial Authority (AFM) is examining the effects of the ban on commission and may adjust the law again.

UK

In the UK following the Retail Distribution Review ("RDR") 70% of mortgage business is carried out via mortgage intermediaries. Deloitte has advised that due to RDR, certain consumers no longer have access to advice and may take inappropriate decisions with many feeling that the products are too complicated. This is specific to products where commission has been banned and largely concerns consumer on lower income.

In 2014 the FSA undertook a Mortgage Market review. Arising from this review the commission model remained unchanged as the industry strongly promoted intermediaries '**Advisory'** benefits - "Choice without advice is useless"

Q6 – 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 interest when consumers are sold products?

It is essential that all remuneration practices promote responsible business conduct, fair treatment of consumers and avoidance of conflicts of interest when consumers are sold products.

Where a variance exists around the remuneration of the initial commission paid to intermediaries for the same product with different product providers, a move to a more standardised approach across all providers would reduce any potential for producer bias.

All commission arrangements should reflect the long term nature of the product and ongoing advice required. Examples include trail and renewal.
We endorse the remuneration model outlined in the Central Bank of Ireland review "Guidelines on Variable Remuneration July 2014".

The Mortgage Credit Regulations require a mortgage credit intermediary to provide information on a durable medium to the consumer in advance of carrying out credit intermediary services. This should be reflected across all product advisory sales.

Q7 – Are there features of the current consumer protection framework that you would highlight as strengths in the context of commissions specifically?

Under the Consumer Protection Code product producers must be able to demonstrate that any commission arrangements based on levels of business introduced do not impair the intermediaries ' duty to act in the best interest of the consumer.

Under the Code an intermediary can only use the word independent in their trading name if they allow the consumer to pay in full for their services by means of a fee. There is a Complaint procedure in place to handle complaints in an effective manner within a specified time frame. In addition the Code states that consumers must be given detailed information in relation to charges, including any third party charges passed onto a consumer. Finally regulated entities must display their charges on their website and in their public office with consumers also given all the necessary warnings on the product purchased.

These requirements reflect the strengths of the current consumer protection framework.

Q8 - Are there weakness or gaps in the current CPC framework in the context of commissions specifically?

Under CPC mortgage and investment intermediaries are required to disclose their remuneration to consumers in their Terms of Business.

Intermediaries are required to prepare and provide a Statement of Suitability to all consumers outlining the reasons why a particular product and provider has been deemed the most suitable (from other products and providers) to meet the clients' needs and requirements.
However for consistency purposes we believe amendment's to the life disclosure notice should reflect the practice in relation to mortgage remuneration.

Q9 – Do you have any other observations on the current domestic framework as it relates to the practice of paying commissions in Ireland?

It should be noted that mortgage and protection commission levels have reduced in the last number of years. Product providers have clawback arrangements in place which essentially monitor the quality and suitability of advice. In addition the spirit of the Consumer Protection Code enforces the current remuneration model. Any proposed change in the current model must take these factors into consideration.

Q10 - Do you have any general views on the potential benefits to consumers of properly designed commission structures outlined in this section?

With respect to mortgages and protection products, it is our opinion that the current commission structure is in the main properly designed and therefore does drive responsible behaviour which promotes responsible business contact, fair treatment of consumers and avoids all conflicts of interest. This is illustrated by the following.

- More choice of products and providers leading to more suitable solutions.
- It is important for intermediaries to maintain ongoing contact with their clients and provide ongoing advice.
- There would be less new entrants in the market if a strong and suitably remunerated intermediary channel did not exist. For example Pepper, Dilosk, Royal London, Zurich and Friends First all distribute exclusively through intermediaries.
- Where a flat level of commission exists e.g. as within the mortgage industry, no producer bias exists.
- The existence of a commission based remuneration model as opposed to fee based ensures an all-inclusive market based advisory service which is open to all consumers regardless of financial means.
- The existence of clawback ensures the client is given appropriate initial advice.
- The commission based model lowers the distribution cost of product producers which in turn enables new market entrants in turn encouraging competition.
- Studies and other markets have shown that consumers will not/do not want to pay for advice. Any change in remuneration may create an advice gap.

Q11 - Are you aware of any potential benefits to consumers if so please describe them?

We believe the potential benefit to consumers of a commission based model to be as follows.

- More choice of products and providers leading to more suitable solutions.
- It is important for intermediaries to maintain ongoing contact with their clients and provide ongoing advice.
- There would be less new entrants in the market if a strong and suitably remunerated intermediary channel did not exist. For example Pepper, Dilosk, Royal London, Zurich and Friends First all distribute exclusively through intermediaries.
- Where a flat level of commission exists e.g. as within the mortgage industry, no producer bias exists.

- The existence of a commission based remuneration model as opposed to fee based ensures an all-inclusive market based advisory service which is open to all consumers regardless of financial means.
- The existence of clawback ensures the client is given appropriate initial advice.
- The commission based model lowers the distribution cost of product producers which in turn enables new market entrants in turn encouraging competition.
- Studies and other markets have shown that consumers will not/do not want to pay for advice. Any change in remuneration may create an advice gap.

Q12 - Have you observed any of these potential benefits? If so please provide examples and describe the kind of benefit that has accrued.

The following examples outline the potential benefits.

1. Client goes direct to a provider and gets one choice of rate and product which may not be the most suitable product to the client's needs. The same client comes to an intermediary who will do a detailed fact find, establish client needs and objectives, undertake market research and will identify a range of options and will provide advice on which is most suitable to the client's needs.
2. Studies show that the economic value of a consumer's experience is more positive through an intermediary than by going direct to a product provider. Reference Jim Power – "The Value of Advice Report 2012"

Q13 - Would you weight any of these potential benefits over others as requiring special consideration or attention, and if so why?

The principal benefit outlined above is the ability to provide consumer choice and advice, therefore ensuring clients' needs is best met.

Q14 - 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?

We believe that the current regulatory framework as set down by the Consumer Protection promotes responsible business conduct, fair treatment of consumers and avoidance of conflicts of interest when consumers are sold financial products. In our opinion the priority of Irish consumers is to obtain the most suitable advice to match their requirements without having to pay for it. Currently mortgages and protection products are provided at no prohibitive cost to the customer as the product provider already has an in built product manufacture and distribution (branch or direct)

Q15 - Do you have any general views on the potential risks to consumers of commission structures outlined in this section?

In the context of mortgages and protection products, we believe the majority of risks outlined in Section 5 are mitigated by:

- Flat commission structure across products and product producers.
- The existence of clawback arrangements
- Intermediaries have an obligation to abide by best advice requirements set out in the Consumer Protection Code 2012.
- Strong competition in the market

- Quality of advice is protected via the requirements and contents of the terms of business document

Q16 - Do you consider the potential risks to be accurately described? If not, please explain why?

Yes however the following greatly minimises potential risks.

- The current macro prudential rules mitigate risk in this regard to overselling credit products.
- In relation to credit products product and producer bias by intermediaries is not accurately described due to the flat commission structure between lenders and no volume based incentives exist.
- More risk if intermediaries did not provide advice to consumers in the market.
- Credit products, mortgage products specifically intermediaries are obliged to demonstrate affordability of products recommended to the consumer therefore risks noted as being specific to commission on credit products do not apply to mortgage credit products.
- Lack of differential pricing on credit products by product providers directly versus via the broker intermediary channel means risk of higher cost of products being offered by the broker intermediary market is negated.

Q17 - Are you aware of any additional potential risks to consumers? If so, please describe them.

We would see a risk if only direct products were offered to consumers and if intermediaries exited the market. Access to products and independent advice is essential for all consumers. If commissions are replaced with fees to remunerate intermediaries, then consumers who cannot afford to pay fee are more vulnerable due to the lack of independent advice.

Q18 - Have you observed any of these potential risks at play? If so, please provide examples and describe the impact of the risk?

As described in Section 5 the Association of Expert Mortgage Advisors has seen no evidence to suggest these potential risks are occurring in the market.

Q19 -Would you weight any of these potential risks over others as requiring special consideration or attention, and if so why?

As described in Section 5 the association of Expert Mortgage Advisors has seen no evidence to suggest these potential risks are occurring in the market.

Q20 - 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 and intermediaries?

The Association of Expert Mortgage Advisors believe that the current framework adequately protects consumers so long as,

- The flat and standard commission structure for mortgage credit currently in existence is maintained.

- The Consumer Protection Code 2012 is adhered to in particular the overriding principal of best advice.
- A level playing field exist for the provision of impartial advice regardless of the channel of distribution.
- Protection product disclosure requirements should be reviewed and updated to reflect changes in the regulatory and legislative environment over the past 15 years.

In summary we believe that the current remuneration structure for intermediaries works well. It facilitates;

(i) Consumer choice
(ii) Competition in the market and facilitates new entrants
(iii) Best advice for the consumer and most importantly,
(iv) Consumer Protection

Consumers favour payment of commissions to fee based remuneration which may not be open to all consumers and may result in a two tiered advisory position where only those who can pay a fee for advice receive best advice. Often a mortgage intermediary will dedicate more time to an application which will yield less remuneration than an application which yields more. Equally advice is often provided in instances where no remuneration is received. If the intermediary channel did not exist then there would be a lack of competition among product providers and fewer new entrants into the market.

The fact that differential pricing does not existing between distribution channels reflects the fact that consumers are not negatively affected by using the services of a professional intermediary. The cost of engaging with an intermediary does not adversely affect the price of the mortgage product.
Overall we are of the opinion that the current commission structure for mortgage intermediaries is fit for purpose.